Taxing Utopia

*Samuel D. Brunson**

Nineteenth-century American religious movements challenged many aspects of American society. Although their challenges to mainstream America's vision of sex and marriage remain the best-known aspects of many of these groups, their challenges to traditional American economics are just as important. Eschewing individual ownership of property, many of these new Christian movements followed the New Testament model of a body of believers that held all property in common.

In the early twentieth century, these religious communal groups had to contend with something new: an income tax. Communalism did not fit into the individualistic economic system envisioned by the drafters of the income tax. So Congress designed a special tax regime, now codified in section 501(d) of the Internal Revenue Code, which exempts religious communal holding companies from tax, while imputing the holding companies' income to the members of the group. Section 501(d) provides communitarian groups with flexibility to reflect their unusual economics.

There exist, however, a number of problems with the design and implementation of section 501(d). This Article will survey the three principal problems. The first is scope: under current law, only religious communitarian groups can elect to use the section 501(d) regime. Second is uncertainty and vagueness in the statute. Third is I.R.S. overreach in the enforcement, applying doctrines (such as the public policy doctrine) that do not apply to section 501(d). In this Article, I discuss why and how to remedy these problems, while not opening section 501(d) to abusive tax avoidance.

* Professor, Loyola University Chicago School of Law. I would like to thank Emily Cauble, Philip T. Hackney, David J. Herzig, Amandeep S. Grewal, Jeffrey L. Kwall, Benjamin M. Leff, and Spencer Weber Waller, as well as the participants in the Second Annual Tax Roundtable and the 18th Annual Critical Tax Scholarship Conference. I would like to thank Jamie Brunson for her support.

I. INTRODUCTION

Nineteenth-century America saw the emergence of a number of charismatic religious movements set on rejecting the wicked world surrounding them and restoring primitive Christianity.[1] For some of these religious movements, rejecting the wicked world also meant jettisoning central values of the surrounding culture. Radically, a number of these religious movements rejected the sexual and familial mores of nineteenth-century America.[2] The Shakers, for example, eschewed sex, choosing to live celibate lives.[3] The Mormons rejected monogamy in favor of polygamy.[4] And the Oneida community

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[1] LAWRENCE FOSTER, RELIGION AND SEXUALITY: THE SHAKERS, THE MORMONS, AND THE ONEIDA COMMUNITY 5–6 (1984).

[2] LOUIS J. KERN, AN ORDERED LOVE: SEX ROLES AND SEXUALITY IN VICTORIAN UTOPIAS—THE SHAKERS, THE MORMONS, AND THE ONEIDA COMMUNITY xii (1981) ("With the exception of slavery, no area of nineteenth-century life commanded as much attention and consumed as a much reform energy as questions of sex, marriage, and the family. . . . [T]he pantagamous Oneida Community . . . the polygamic Mormons . . . and the celibate Shakers . . . consciously sought to provide social alternatives to monogamous marriage.").

[3] Ralph Michael Stein, *A Sect Apart: A History of the Legal Troubles of the Shakers*, 23 ARIZ. L. REV. 735, 739 (1981).

[4] Janet Bennion, *History, Culture, and Variability of Mormon Schismatic Groups*, *in* MODERN POLYGAMY IN THE UNITED STATES: HISTORICAL, CULTURAL, AND LEGAL ISSUES 101, 102 (Cardell K. Jacobson & Lara Burton eds., 2011); Samuel D. Brunson, *Taxing*

embraced "complex marriage," a type of group marriage that "resulted in radical changes in sex roles and behavior."[5]

Of course, while rejecting the surrounding world's marital and sexual norms represents perhaps the most memorable feature of these restorationist Christian movements, they did not view the wicked world's sexual and marital practices as its only objectionable practices. And while the groups' alternative approaches to sex and marriage may be the most salacious part of their rejection of the surrounding culture, their new sexual and marital practices were neither the most interesting nor the most important way in which they differed from the mainstream culture. Equally interesting, and far more successful, was their approach to economic life.

The Shakers, the Mormons, and the Oneida community—as well as many other nineteenth-century religious groups[6]—implemented some version of economic communitarianism,[7] attempting to recreate the Apostolic society of the New Testament.[8] Eschewing the private ownership of property, they instead gave their private property to—and subjugated their selfish desires for—the benefit of a group, which, in turn, provided them with sustenance and community. This voluntary self-denial, while central to the project of communalism,[9] is broadly inimical to the myth of individualism so foundational to Americans' understanding of themselves.[10]

Although their communitarian practices violated American economic norms, the country ultimately tolerated—and, in fact,

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Polygamy, 91 WASH. U. L. REV. 113, 131 n.112 (2013) [hereinafter Brunson, *Taxing Polygamy*].

5 FOSTER, *supra* note 1, at 5.

6 *See* CHRIS JENNINGS, PARADISE NOW: THE STORY OF AMERICAN UTOPIANISM 7 (2016) ("At least one hundred experimental [communalist] communities were founded in the United States during the nineteenth century and countless more since.").

7 LAWRENCE FOSTER, WOMEN, FAMILY, AND UTOPIA: COMMUNAL EXPERIMENTS OF THE SHAKERS, THE ONEIDA COMMUNITY, AND THE MORMONS xiv (1991).

8 According to the Bible, the early Apostolic church practiced communitarian economics. Believers did not claim private ownership over their assets, but instead, they held everything in common. *Acts* 4:32. Upon joining, these early Christians sold whatever assets they had and gave the proceeds to the apostles, who then distributed those assets by need. *Acts* 4:32–35; *see also Acts* 2:44–45. As a result of this communal living, "there was not a needy person among" these early Christians. *Acts* 4:34.

9 TIMOTHY MILLER, THE QUEST FOR UTOPIA IN TWENTIETH-CENTURY AMERICA: VOLUME 1: 1900–1960, at xx (1998) [hereinafter MILLER, QUEST FOR UTOPIA] ("Communitarianism is predicated upon some degree of suppression of individualism and the pursuit of the common, not just the individual, good.").

10 *See, e.g.*, PETER L CALLERO, THE MYTH OF INDIVIDUALISM: HOW SOCIAL FORCES SHAPE OUR LIVES 18 (2d ed. 2013) ("American society is saturated with the holy waters of individualism.").

accommodated—this particular religiously-inspired difference.[11] In the early twentieth century, the U.S. introduced a federal income tax that could have devastated communitarian societies. Communalism did not fit into the individualistic economic system envisioned by the drafters of the income tax. At the same time, though, these communitarian groups engaged in commerce, so, unlike churches and other public charities, they did not belong entirely outside of the tax system. After a quarter-century of uneasy engagement with the tax system, Congress drafted a tax provision applicable solely to these religious communitarian groups.

There is nothing unusual about drafting tax provisions targeted at small groups, of course. Congress continually enacts this type of legislation.[12] That such targeted tax provisions are common, though, hardly serves to recommend them: even Congress recognizes that "[t]argeted tax provisions based on narrow social and economic goals (as distinguished from revenue raising)" form the heart of tax complexity.[13] And this provision—now codified in section 501(d) of the Internal Revenue Code ("section 501(d)")—currently applies to just over 200 communal groups and their members.[14]

Unlike many targeted tax provisions, though, section 501(d) probably does not add significant complexity to the tax law. Because it is targeted at very few taxpayers, section 501(d) remains relatively obscure, largely ignored, and unknown by the population at large. It also solves a very real problem that the existence of these groups creates: how to apply a tax regime that assumes individuality and selfishness to taxpayers who eschew such things.

Still, its obscurity, as well as its mischaracterization as a tax exemption, have caused the Internal Revenue Service ("I.R.S.") to radically misunderstand section 501(d). As a result of its misunderstanding both the economic function and the application of section 501(d), the I.R.S. has imported requirements from the world

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11 By way of contrast, U.S. law and culture largely have not embraced these groups' alternative sexual and marital practices. *See, e.g.*, Brunson, *Taxing Polygamy*, *supra* note 4, at 114–15.

12 Kristin E. Hickman, *Administering the Tax System We Have*, 63 DUKE L.J. 1717, 1722 (2014).

13 Ad Hoc Comm. on Tax Reform, *Tax Reform: The Business Perspective*, 41 BUS. LAW. 907, 908 (1986).

14 In 2015, there were 217 recognized religious and apostolic groups that were exempt under section 501(d). I.R.S., 2015 DATA BOOK 58 tbl. 25 (2016), https://www.irs.gov/pub/irs-soi/15databk.pdf. The number of exempt communitarian religious organizations had increased significantly since the beginning of the century, from 131 in 2002. I.R.S., 2003 DATA BOOK 30 tbl. 22 (2003), http://www.irs.gov/pub/irs-soi/03databk.pdf.

of tax-exempt public charities that have no place in taxing communitarian groups.

Even if the I.R.S. properly understood the place of section 501(d), the provision has two significant problems that Congress or the Treasury Department needs to address. The first problem is scope: under current law, only religious communal groups can elect to use the section 501(d) regime. This makes sense from a historical perspective: Congress was trying to fix a problem for certain religious communal groups when it passed section 501(d). Today, though, outside of its history, there is no tax policy reason—compelling or otherwise—to bar secular communitarian groups from also qualifying for exemption under section 501(d).

Second, although section 501(d) is a short provision of the tax law, consisting of only one hundred words, several of its key requirements remain undefined and ambiguous. As a result, uncertainty exists for many organizations over whether they qualify for the exemption. In some cases, that uncertainty may prevent a qualified communitarian organization from applying for exemption under section 501(d). In other cases, it has led to litigation.[15]

This Article will highlight the beneficial uses and potential of section 501(d), while at the same time proposing correctives to the problems of section 501(d). Part II will present a case study illustrating the I.R.S.'s misunderstanding of section 501(d), with the I.R.S. conflating the sexual and the economic aspects of communitarian organizations. Because the I.R.S. misunderstands the purpose and the place of communitarian organizations, it over-enforces qualification criteria that do not and need not apply, unnecessarily limiting the types of organizations that should be able to elect the special tax treatment provided by section 501(d).

In Part III, this Article will review the history of communitarian organizations—both religious and non-religious—in the United States. Part IV will proceed to follow the developments in the taxation of communitarian organizations, from courts' initial rejection of their charitable status to Congress's enactment of a specialized exemption for certain religious communitarian organizations.

In Part V, the Article will explore whether the Internal Revenue Code ("the Code") needs a special provision for communitarian organizations, or if the existence of such a provision adds unnecessary complexity to the Code. The Article will do so by analyzing how three

[15] *See, e.g.*, Twin Oaks Cmty., Inc. v. Comm'r, 87 T.C. 1233, 1242 (1986) (I.R.S. argued that members must take "vow of poverty" for organization to qualify as having communal or community treasury), *acq.*, 1987-2 C.B. 1.

other tax regimes would apply to communitarian groups and evaluating whether those regimes could accurately reflect the economics of these organizations.

Part VI will then suggest a number of changes Congress should make to improve and modernize section 501(d). Most importantly, Congress should extend the exemption to non-religious communitarian organizations. In addition, though, there are a handful of ambiguities and tax-planning opportunities in the rules that Congress could easily repair. Part VI will discuss those improvements that Congress could, and should, make.

II. I.R.S. OVERREACH IN SECTION 501(D)

Under section 501(d), a qualifying "religious or apostolic" organization with a common or community treasury can elect to be exempt from tax.[16] The exemption is not complete, though: although the communitarian organization itself pays no taxes, its members do pay taxes on their pro rata share of the organization's income, whether or not it distributes that income to them.[17]

For tax purposes, then, section 501(d) organizations function more like pass-through entities than tax-exempt entities. Still, the fact that the special tax provision speaks of exemption and is located in the same section of the Code as other tax exemptions appears to have caused the I.R.S. to misapprehend the history and economic substance of the provision. In a 2013 private letter ruling, the I.R.S. held that a polygamous group failed to qualify as an exempt religious or apostolic organization because polygamy is both illegal and contrary to public policy.[18] The public policy requirement does not, however, apply to exemptions under section 501(d). Furthermore, no tax policy reason justifies importing such a requirement into this exemption from taxation.[19]

Nonetheless, whether from a lack of understanding about the unique economics of section 501(d), from pure administrative overreach, or for some other reason, the I.R.S. has imposed qualification requirements on religious and apostolic organizations that do not derive either from the Code or the case law. Moreover,

[16] I.R.C. § 501(d) (2015).

[17] *Id.* For a discussion of the definitions of *religious or apostolic, common or community treasury,* and *pro rata* as used in section 501(d), see *infra* Part VI.A-B.

[18] I.R.S. Priv. Ltr. Rul. 2013-10-047 (Mar. 8, 2013).

[19] Although this Article will briefly review the history and the scope of the public policy doctrine, an in-depth analysis of the doctrine is beyond the scope of this Article and will, instead, be treated in a future article.

because communitarian organizations may lack the resources to challenge the I.R.S.'s determination, these administrative overreaches can potentially continue unchallenged.[20] As long as the I.R.S. reads an inapplicable public policy requirement into section 501(d), it will unnecessarily discourage organizations that should elect this exemption from doing so.

A. *History of Public Policy Requirement*

The public policy requirement provides that an organization seeking "charitable tax subsidies . . . may not engage in activities antithetical to established public policy."[21] This requirement does not find its roots either in the Code or in the Treasury regulations. Rather, it originated in the District Court for the District of Columbia's decision in *Green v. Kennedy*.[22] The plaintiffs in that case consisted of African American parents living in Mississippi whose children had been denied entrance into private schools because of their race.[23] The plaintiffs sought a preliminary injunction preventing the I.R.S. from granting a tax exemption to racially discriminatory schools and from permitting donors to such schools to deduct their donations, as well as requiring the I.R.S. to revoke the exemptions already granted to racially discriminatory schools.[24]

The court found that, although the exemption and deductions did not involve direct tuition grants by the government, they did provide "substantial and significant support by the Government to the segregated private school[s]."[25] In fact, the tax exemption and deduction available to donors significantly aided the private schools in raising funds, and thus, in discriminating.[26] Although the court did not require the I.R.S. to revoke the exemptions of racially

[20] *See* Samuel D. Brunson, *Watching the Watchers: Preventing I.R.S. Abuse of the Tax System*, 14 FLA. TAX REV. 223, 232 (2013) ("[P]olicing [the I.R.S.] imposes a cost—potentially significant—on taxpayers. As a result of this cost, they may not have sufficient incentive to challenge the I.R.S.'s misinterpretations, even when they have a strong case.").

[21] Miranda Perry Fleischer, *Theorizing the Charitable Tax Subsidies: The Role of Distributive Justice*, 87 WASH. U. L. REV. 505, 532 (2010).

[22] Green v. Kennedy, 309 F. Supp. 1127 (D.D.C. 1970).

[23] *Id.* at 1129.

[24] *Id.* at 1130.

[25] *Id.* at 1134.

[26] *Id.* at 1135. In fact, fundraising letters from the schools to potential donors emphasized that without their (tax-deductible) support, "many students, whose minds and bodies are just as pure as those of any of their classmates and playmates . . . w[ill] be forced into one of the intolerable and repugnant 'other schools,'" or forced into dropping out altogether. *Id.*

discriminatory schools that had already received their tax exemption, it decided that a "broad public interest" existed in enjoining the I.R.S. from granting tax-exempt status to such schools during the pendency of the litigation.[27]

Shortly after the court issued its preliminary injunction, the I.R.S. announced that it could no longer provide a tax exemption to racially discriminatory private schools or allow taxpayers to deduct their donations to such schools.[28] Randolph W. Thrower, the Commissioner of the I.R.S., clarified the I.R.S.'s position, explaining that an organization seeking tax-exemption and deductible donations under sections 501(c)(3) and 170 of the Code had to meet the common law tests for being "charitable."[29]

The following year, when the district court decided the case on its merits, the court adopted the I.R.S.'s focus on "charitable."[30] Section 501(c)(3) uses "[t]he term *charitable* . . . in its generally accepted legal sense";[31] as a result, at least for close questions, the court could look to the common law of charitable trusts.[32] Central to the law of charitable trusts is the concept that such a trust must "serve the general welfare and be 'beneficial to the community.'"[33]

According to the court, however, community benefit changes over time, making it impossible to formalize criteria with which to identify appropriate benefits.[34] Thus, analyzing a charitable trust's community benefit requires courts to take into account contemporary mores.[35] However, to qualify as serving the general welfare and benefiting the community, a charitable trust's purpose cannot be "illegal or contrary to public policy."[36]

The common law prohibition on charities engaging in acts that are illegal or contrary to public policy also informs Congressional

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[27] *Id.* at 1138.

[28] The I.R.S. announced its changed policy in two news releases, dated July 10 and July 19, 1970. The news releases are reprinted in the Senate testimony of I.R.S. Commissioner Randolph W. Thrower on equal educational opportunity. *See Equal Educational Opportunity: Hearings Before the Select Comm. on Equal Educational Opportunity of the United States Senate*, 91st Cong., 2d Sess. 1996–97 (1970) (statement of Randolph W. Thrower, Comm'r of Internal Revenue Service).

[29] *Id.* at 1995.

[30] Green v. Connally, 330 F. Supp. 1150, 1157 (D.D.C. 1971), *aff'd*, 404 U.S. 997 (1971).

[31] Treas. Reg. § 1.501(c)(3)-1(d)(2) (2014) (emphasis added).

[32] *Connally*, 330 F. Supp. at 1157.

[33] *Id.* at 1158.

[34] *Id.*

[35] *Id.* at 1159.

[36] *Id.*

intent with respect to deductions and tax exemption.[37] The charitable exemption and charitable deduction could not be used to frustrate explicit federal policy, including policy on racial discrimination.[38] Thus, in holding that the I.R.S. could not grant a tax exemption to racially discriminatory private schools, the court imported the public policy requirement from the common law of charitable trusts into the tax exemption and deduction for public charities.

In 1971, the I.R.S. issued a revenue ruling formally adopting the policy that racially discriminatory private schools did not qualify as tax-exempt under section 501(c)(3).[39] Underlying this rule, the I.R.S. explained, was the common law of charities. The common law definition of "charity," the I.R.S. explained, encompassed all three major categories of exempt organizations listed in section 501(c)(3): charitable, educational, and religious.[40] Although federal law did not prohibit private schools from discriminating, well-settled federal policy discouraged such discrimination.[41] The common law prohibited charitable trusts of any kind from acting contrary to public policy.[42] As such, the I.R.S. could not grant tax-exempt status under section 501(c)(3) to private schools that discriminated on racial grounds.[43]

In 1970, the I.R.S. requested proof from private schools that they followed nondiscriminatory admissions processes.[44] Bob Jones University, a private religious school in Greenville, South Carolina, told the I.R.S. that it did not admit African Americans, and, in September 1971, further asserted that it would not admit African American students.[45] The I.R.S. initiated proceedings to revoke the university's tax exemption.[46] Bob Jones University filed suit for injunctive relief, however, blocking the I.R.S.'s preparation.[47] Ultimately, the Supreme Court held that the Anti-Injunction Act blocked the suit,[48] and, in January 1976, the I.R.S. revoked Bob Jones

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[37] *Id.* at 1161.

[38] *Connally*, 330 F. Supp. at 1164.

[39] Rev. Rul. 71-447, 1971-2 C.B. 230.

[40] *Id.*

[41] *Id.*

[42] *Id.* *See also* RESTATEMENT (THIRD) OF TRUSTS § 27 cmt. a (2003) ("[Charitable] trust purposes and provisions must not be unlawful or contrary to public policy . . . .").

[43] Rev. Rul. 71-447, 1971-2 C.B. 230.

[44] Bob Jones Univ. v. Simon, 416 U.S. 725, 735 (1974).

[45] *Id.* at 734–35. The university forbade interracial dating, based on its interpretation of the Bible, but believed that the only way to enforce such a prohibition was by refusing to admit African American students. *Id.* at 735.

[46] *Id.*

[47] *Id.*

[48] *Id.* at 749.

University's section 501(c)(3) tax-exempt status, effective as of December 1, 1970.[49]

Bob Jones University ultimately appealed the revocation to the Supreme Court, where it argued that the plain language of section 501(c)(3)—which specifically includes educational purposes among purposes entitled to tax exemption—guaranteed them tax-exempt status.[50] The Code, it pointed out, included no express requirement that all exempt organizations meet the common law definition of *charitable*.[51] In fact, the list of acceptable exempt purposes in section 501(c)(3) was disjunctive, belying the requirement that all exempt entities had to qualify as charitable.[52] Rather, the University argued, under section 501(c)(3), an organization that fell within any of the categories listed automatically qualified as tax-exempt.[53]

The Supreme Court disagreed that the categories were disjunctive. Rather, it determined that "Congress sought to provide tax benefits to charitable organizations, to encourage the development of private institutions that serve a useful public purpose or supplement or take the place of public institutions of the same kind."[54] As a corollary to this public benefit requirement, the Supreme Court agreed with the I.R.S. that violations of public policy were inconsistent with tax exemption.[55] The Supreme Court held that determining what constituted a violation of public policy fell within the I.R.S.'s authority.[56] Ultimately, then, an organization that violates a clear public policy does not qualify as tax-exempt under section 501(c)(3).[57]

B. *The Reach of the Public Policy Doctrine*

Although the Supreme Court only adopted the public policy rule with respect to entities seeking exemption under section 501(c)(3),[58] we must nonetheless explore whether, as a normative matter, the Fundamentalist Church of Jesus Christ of Latter-Day Saints (or any religious or apostolic organization that violates public policy) should

[49] Bob Jones Univ. v. United States, 461 U.S. 574, 581 (1983).
[50] *Id.* at 585.
[51] *Id.*
[52] *Id.* *See* I.R.C. § 501(c)(3) (2015) (to qualify for exemption, organizations must be "organized and operated exclusively for religious, charitable, scientific, testing for public safety, literary, or educational purposes . . . .").
[53] *Bob Jones Univ.*, 461 U.S. at 585–86.
[54] *Id.* at 588.
[55] *Id.* at 591.
[56] *Id.* at 596.
[57] *See, e.g.*, Rev. Rul. 75-231, 1975-1 C.B. 158.
[58] *See supra* Part II.A.

receive tax benefits. That is, section 501(d) reduces the collective amount of taxes paid by religious and apostolic organizations and their members by implementing a single level of taxation. If those organizations' actions or teachings violate public policy, perhaps the tax law should import the public policy doctrine to prevent the violation.

At one time, courts applied the public policy doctrine not only to entities exempt from taxation under section 501(c)(3), but, in limited circumstances, to for-profit businesses.[59] The tax law generally permits businesses to deduct "all the ordinary and necessary expenses paid or incurred . . . in carrying on any trade or business."[60] In the 1950s, though, the Supreme Court held that an expense did not qualify as *necessary* "if allowance of the deduction would frustrate sharply defined national or state policies proscribing particular types of conduct, evidenced by some governmental declaration thereof."[61]

Congress partially codified this denial of deductions that violate public policy by disallowing deductions for certain bribes, kickbacks, other illegal payments, and for fines and other penalties incurred for breaking the law.[62] As part of its codification, however, Congress superseded and limited the judicially-promulgated public policy rule.[63] Only those deductions Congress explicitly laid out in the Code were to be denied as violating public policy.[64]

Today, then, taxpayers involved in illegal businesses must report and pay taxes on their illegal income.[65] In calculating their taxable income, however, courts consistently permit illegal businesses to deduct typical business expenses.[66] For example, courts have allowed bookies to deduct rents and salaries paid.[67] They have permitted the

[59] JOINT COMM. ON TAXATION, 91ST CONG., GENERAL EXPLANATION OF THE TAX REFORM ACT OF 1969, at 233 (Comm. Print 1970) (under prior law, "a number of business expenses were disallowed on the ground that the allowance of these deductions would be contrary to Federal or State 'public policy'").

[60] I.R.C. § 162(a) (2012).

[61] Tank Truck Rentals, Inc. v. Comm'r, 356 U.S. 30, 33–34 (1958).

[62] *See* I.R.C. § 162(c) (2012); Edward J. Roche, Jr., *Federal Income Taxation of Medical Marijuana Businesses*, 66 TAX LAW. 429, 435–36 (2013).

[63] S. REP. NO. 91-552, at 2311 (1969) (Conf. Rep.) ("Public policy . . . generally is not sufficiently clearly defined to justify the disallowance of deductions.").

[64] *Id.* ("The provision for the denial of the deduction for payments in these situations which are deemed to violate public policy is intended to be all inclusive.").

[65] United States v. Sullivan, 274 U.S. 259, 263 (1927) ("We see no . . . reason why the fact that a business is unlawful should exempt it from paying the taxes that if lawful it would have to pay.").

[66] Roche, *supra* note 62, at 433.

[67] English v. Comm'r, 249 F.2d 432, 433 (7th Cir. 1957).

proprietors of a massage and prostitution business to deduct ordinary business expenses (including, *inter alia*, office furnishings, telephones, and advertising).[68] In fact, the I.R.S. has held that an arms dealer, making illegal sales to foreign governments, could deduct the cost of payments it made to procure arms contracts.[69]

Ultimately, outside of the section 501(c)(3) exemption, the tax law is largely agnostic as to the legality and appropriateness of taxpayers' actions. Instead,

> the federal income tax is a tax on net income, not a sanction against wrongdoing. That principle has been firmly imbedded in the tax statute from the beginning. One familiar facet of the principle is the truism that the statute does not concern itself with the lawfulness of the income that it taxes. Income from a criminal enterprise is taxed at a rate no higher and no lower than income from more conventional sources.[70]

Clearly, if a religious or apostolic organization violates public policy, the government should act to stop that violation, and perhaps should censure the organization. Such prevention and censure, however, should occur outside of the tax law. The tax law, without explicit Congressional action, generally—and rightly—does not concern itself with the appropriateness of a taxpayer's action, but rather with raising the appropriate revenue as a result of that action.

C. *Public Policy and Other Exempt Organizations*

The I.R.S. has taken the position that social welfare groups, exempt from taxation under section 501(c)(4), also cannot engage in illegal conduct.[71] In a revenue ruling, the I.R.S. determined that an antiwar organization that organized protests and encouraged nonviolent civil disobedience did not qualify for exemption either as a public charity under section 501(c)(3) or as a social welfare organization under section 501(c)(4).[72] In its section 501(c)(3) analysis, the I.R.S. mentioned that, because section 501(c)(3)'s definition of "charitable" derived from the law of charitable trusts, an applicant for exempt status under section 501(c)(3) could not act illegally or in violation of public policy.[73]

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[68] Toner v. Comm'r, 60 T.C.M. (CCH) 1016, 1021 (1990), *aff'd*, 958 F.2d 362 (3d Cir. 1992).

[69] I.R.S. Field Serv. Advisory 2001-28-004 (Jul. 13, 2001).

[70] Comm'r v. Tellier, 383 U.S. 687, 691 (1966).

[71] Rev. Rul. 75-384, 1975-2 C.B. 204.

[72] *Id.*

[73] *Id.*

Notably, the analysis of section 501(c)(4) in the same revenue ruling made no mention of the public policy requirement.[74] Instead, the I.R.S. found that the antiwar group did not qualify under section 501(c)(4) because "[i]llegal activities . . . are contrary to the common good and the general welfare of the people in a community and thus are not permissible means of promoting the social welfare for purposes of section 501(c)(4) of the Code."[75] Apparently, the I.R.S. did not believe that the broad public policy requirement applied to tax exemptions outside of section 501(c)(3). In explaining its holding, the I.R.S. does not argue that any organization that acts illegally cannot qualify for a tax exemption. Rather, it argues that illegal activities do not bring about "social betterments and social improvements," the *sine qua non* of social welfare groups qualifying under section 501(c)(4).[76]

Professor Benjamin Leff has argued persuasively that the public policy's derivation from the common law of charities means that its application must be limited to entities seeking exemption under section 501(c)(3) of the Code.[77] Professor Leff also argues that, as a normative matter, the I.R.S. *should* permit entities that meet the other requirements to qualify as exempt social welfare organizations under section 501(c)(4).[78]

Professor Leff acknowledges the controversial nature of his argument that the I.R.S. should permit at least some entities that violate federal law to qualify as exempt under section 501(c)(4).[79] In fact, Professor Philip Hackney has responded to Professor Leff, arguing that the public policy requirement should apply more broadly than merely to organizations exempt under section 501(c)(3).[80] Though Professor Hackney acknowledges that, as a general rule, the tax law does not police illegality, he argues that tax exemptions are

[74] *Id.*

[75] *Id.*

[76] *Id.*

[77] *See* Benjamin Moses Leff, *Tax Planning for Marijuana Dealers*, 99 IOWA L. REV. 523, 536 (2014).

[78] *Id.* at 537 ("Therefore, I am arguing that the I.R.S. should recognize the tax-exempt status under § 501(c)(4) of a social welfare organization whose primary activity is illegal—even criminal—under federal law.").

[79] *Id.* ("I understand that such an argument is controversial . . . .").

[80] Philip T. Hackney, *A Response to Professor Leff's Tax Planning "Olive Branch" for Marijuana Dealers*, 99 IOWA L. REV. BULL. 25, 26 (2014) ("I contend that the public policy doctrine should apply with equal force to social welfare organizations and charitable organizations, as these organizations are merely kissing cousins without significant structural differences.") (footnote omitted).

different.[81] A tax exemption, he argues, is primarily a subsidy.[82] Because the government (and, by extension, taxpayers) subsidize tax-exempt organizations, it makes sense to broadly prohibit them from violating the law or public policy.

Even if Professor Hackney is correct about the scope of the public policy doctrine, though, his reasoning does not extend to entities exempt under section 501(d). As I have demonstrated in this Article, the exemption under section 501(d) does not function as a subsidy.[83] Instead, the tax exemption for religious and apostolic organizations attempts to accurately reflect the economics of communitarian organizations.[84] This is precisely what Professor Hackney argues, correctly, that most tax exemptions do not attempt. Thus, even if Professor Hackney is correct that the public policy doctrine should find itself rooted in tax exemption rather than the common law of charitable trusts, its reach should end at section 501(d). As long as the I.R.S. does not demand that other pass-through entities—including partnerships, S corporations, and regulated investment companies—meet the public policy requirement, it should not hold communitarian organizations to such a requirement.

D. *Public Policy and Religious or Apostolic Communitarian Groups*

The I.R.S. has no legal or policy basis for requiring applicants for exemption under section 501(d) to meet the public policy requirement. Nonetheless, it has demonstrated that it broadly reads that requirement into section 501(d). In a private letter ruling issued in 2013, the I.R.S. disallowed a polygamous group's exemption under 501(d).[85] Although the I.R.S. redacts identifying information from private letter rulings,[86] it, perhaps unintentionally, left information that indicates that the polygamous group in question was the Fundamentalist Church of Jesus Christ of Latter-Day Saints ("FLDS Church").[87]

[81] *Id.* at 31.

[82] *Id.*

[83] *See infra* notes 213–219 and accompanying text.

[84] *See infra* notes 236–242 and accompanying text.

[85] I.R.S. Priv. Ltr. Rul. 2013-100-47 (Dec. 11, 2012).

[86] I.R.C. § 6110(c)(1) (2012).

[87] Specifically, the private letter ruling refers to a "news article from Examiner.com . . . report[ing] that a court in your state found a leader [of your church] with three wives under 'celestial marriages' guilty of bigamy." I.R.S. Priv. Ltr. Rul. 2013-100-47 (Dec. 11, 2012). Similarly, Texas Monthly reported that FLDS leader Wendell Nielsen was convicted of bigamy for celestial marriage with three women. Katy Vine, *FLDS Leader Convicted in Historic Bigamy Case*, TEXAS MONTHLY (Jan. 21, 2013), https://perma.cc/6886-UJU5. Arguably, leaving that information in the letter

Although the Church of Jesus Christ of Latter-day Saints ("LDS Church") discontinued its practice of polygamy in 1890,[88] some members continued to believe that polygamy was a necessary and divinely sanctioned practice.[89] The LDS Church continued to condemn polygamy and its sympathizers into the 1920s and early 1930s, forcing those polygamists and sympathizers to leave the LDS church and establish the predecessor to the FLDS Church.[90]

Though its practice of polygamy distinguishes the FLDS Church in mainstream consciousness, its marital practices represent only one way it differs from its surrounding culture.[91] Notably, as with other groups discussed in this Article, members of the FLDS Church engage in a type of communal economic life.[92]

Several times in the nineteenth century, the LDS Church experimented with communalism. Between 1831 and 1833, Joseph Smith, the founder of the LDS Church, implemented a communal economic order in which members "consecrated" their property by deeding it to a representative of the church.[93] The representative then returned the property "as a life lease, together with land and materials

ruling fails to meet the privacy requirements of the Treasury regulations. *See* Treas. Reg. § 301.6110-3(a)(1)(ii) (1977) (requiring the deletion of "[a]ny other information that would permit a person generally knowledgeable with respect to the appropriate community to identify any person").

[88] *See* Bennion, *supra* note 4, at 102. While the LDS Church originally discontinued the practice of polygamy in 1890, members "grappled with what the Woodruff Manifesto [which ended polygamy] meant." John Bennion, *Mary Bennion Powell: Polygamy and Silence*, 24 J. MORMON HIST. 85, 87–88 (1998). Members of the LDS Church debated whether those in polygamous marriages were to separate, whether it merely meant that no new polygamous marriages would be solemnized, or whether it meant that members could continue to enter into polygamous marriages as long as they did so outside of the United States. *Id.* at 88. In 1904, the LDS Church released a second, unambiguous statement clearly renouncing polygamy. *Id.* at 87.

[89] Ken Driggs, *After the Manifesto: Modern Polygamy and Fundamentalist Mormons*, 32 J. CHURCH & ST. 367, 375 (1990) ("But significant numbers of Mormons never accepted the demise of [polygamy].").

[90] *Id.* at 377 (describing that in 1933 "the last tolerance for diehards ended and an almost open war erupted between the [LDS] Church and the smaller body that came to call itself the Fundamentalist Church of Jesus Christ of Latter-day Saints") (footnote omitted).

[91] Eric G. Andersen, *Protecting Religious Liberty Through the Establishment Clause: The Case of the United Effort Plan Trust Litigation*, 2008 UTAH L. REV. 739, 741 ("The Church has made headlines over the years because of its practice of polygamy . . . .").

[92] *See, e.g.*, *id.* ("An element of the Church's communal life . . . is an economic arrangement that came to be called the 'United Effort Plan' (UEP). It involves the common ownership of assets, especially real property . . . ."); Bennion, *supra* note 4, at 102 ("The movement relied on early Brigham Young doctrines of communalism and plural marriage . . . .").

[93] Dean L. May, *One Heart and Mind: Communal Life and Values Among the Mormons*, *in* AMERICA'S COMMUNAL UTOPIAS 135, 140–41 (Donald E. Pitzer ed., 1997).

sufficient to make a living at his chosen profession."[94] Although the LDS church never reintroduced this communalism during Smith's lifetime,[95] his successor Brigham Young tried to implement various versions of communalism in the 1850s and 1870s.[96]

The FLDS Church inherited this communal impulse. Established in a remote and isolated area on the Utah-Arizona border, adherents would move to the area, purchase land, and deed it to the FLDS Church.[97] Though the legal forms of its earliest communal efforts have been lost,[98] in 1942, the FLDS Church formed the United Effort Plan Trust ("UEP Trust"), which owned the consecrated property.[99]

As with the LDS Church's nineteenth-century experiments with communalism, although members of the FLDS Church deeded their land to the UEP Trust, they still had access to UEP Trust property. The Trust assigned lots of land to members and encouraged them to build and improve homes on those lots.[100] In addition, the UEP Trust gave plots of land to individuals for farming, operated several commercial enterprises that employed members of the FLDS Church, and provided services to members.[101]

In its ruling, the I.R.S. acknowledges that the FLDS Church meets the textual requirements of section 501(d). The FLDS Church meets the implicit requirement that it have a religious or apostolic character.[102] In addition, it meets both explicit requirements: that it maintains a common treasury, and that its trust documents require members to include their pro rata share of the FLDS Church's taxable income in gross income.[103]

In spite of the FLDS Church's compliance with section 501(d),

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94 *Id.* at 141.

95 *Id.* at 142.

96 *Id.* at 146–48.

97 Jeffs v. Stubbs, 970 P.2d 1234, 1239 (Utah 1998).

98 Andersen, *supra* note 91, at 744 ("The legal status of the group's earliest communitarian economic arrangements is unclear.").

99 *Id.* at 744.

100 *Jeffs*, 970 P.2d at 1239.

101 *Id.* at 1240 ("In 1986, Jeffs declared that all those living on UEP land were tenants at will."); IRWIN ALTMAN & JOSEPH GINAT, POLYGAMOUS FAMILIES IN CONTEMPORARY SOCIETY 63 (1996). Altman and Ginat actually do not name the polygamous group they describe, calling it, instead, the United Fundamentalist Church. *Id.* at 62. Certain descriptions of the pseudonymous United Fundamentalist Church—especially the fact that it considers those who live on its land to be tenants at will—match the descriptions of the FLDS Church. *See id.* at 63 (explaining that members who build on church land are tenants at will).

102 I.R.S. Priv. Ltr. Rul. 2013-100-47 (Dec. 11, 2012).

103 *Id.*

though, the I.R.S. rejected its application for exemption under section 501(d), using essentially identical reasoning as it used to reject Principle Voices of Polygamy's application for exemption under section 501(c)(3).[104] The I.R.S. adopted the public policy analysis wholesale.

The I.R.S. appears to recognize that the public policy requirement does not inherently map onto the requirements of section 501(d). It asserts, however, that although section 501(d) "does not require explicit proof of charitable purposes, as does section 501(c), courts have found an implicit requirement."[105] It cites *Kleinsasser ex rel. Kleinsasser v. United States*[106] to support its assertion of an implicit charitable requirement. Unfortunately, *Kleinsasser* makes no such finding. In fact, the court in *Kleinsasser* contrasts the need for a charitable function under section 501(c)(3) with section 501(d)'s focus on form.[107]

Requiring section 501(d) organizations to meet the public policy requirement finds no support in the Code, the case law or any other tax policy consideration. Congress has broadly rejected the application of public policy to the tax law, except in the narrow area of charitable organizations.[108] Partnerships, for example, do not lose their pass-through status solely because they violate public policy (or, for that matter, violate the law). Although not identical, the exemption under section 501(d) resembles partnership pass-through treatment more than it does a charitable exemption from taxation.[109]

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[104] *See infra* notes 304–306 and accompanying text.

[105] I.R.S. Priv. Ltr. Rul. 2013-100-47 (Dec. 11, 2012).

[106] Kleinsasser *ex rel.* Kleinsasser v. United States, 707 F.2d 1024 (9th Cir. 1983).

[107] *Id.* at 1029 ("Nothing about the doctrine of 'unrelated trade or business' has any relevance to a § 501(d) organization because this organization is granted its exemption not because of function, but because of *form.*"). The I.R.S. also cites two revenue rulings for the proposition that an organization seeking exemption under section 501(d) needs to "serve a public purpose and not be contrary to established public policy." I.R.S. Priv. Ltr. Rul. 2013-100-47 (Dec. 11, 2012). Neither revenue ruling applies to religious or apostolic organizations, though, and they provide no support for the assertion that section 501(d) has an implicit public policy requirement. Rather, one revenue ruling applies the public policy requirement to private schools with racially-discriminatory policies. Rev. Rul. 71-447, 1971-2 C.B. 230. The other deals with antiwar protest groups seeking exemption under section 501(c)(3) or section 501(c)(4). Rev. Rul. 75-384, 1975-2 C.B. 204.

[108] *See supra* Part II.C.

[109] *See* Kleinsasser *ex el.* Kleinsasser v. United States, 707 F.2d 1024, 1026 (9th Cir. 1983) ("The liability for members of § 501(d) organizations is determined through application of partnership accounting principles."); Riker v. Comm'r, 244 F.2d 220, 230 (9th Cir. 1957) ("One might assume, then, that Congress intended an association somewhat akin to the ordinary association or partnership in which each member has a definite, though undivided, interest in the business conducted for the common

Whether or not it expands the availability of the religious and apostolic exemption, then, Congress should rein in the I.R.S. as it responds to applications for exemption under section 501(d). The courts have not compelled the I.R.S. to add any requirements for exemption under section 501(d) to those listed in the Code. The underlying justification for the public policy requirement applies solely to tax-exempt organizations that, unlike communitarian organizations, find their tax exemption rooted in the law of public charities.[110] By imposing requirements beyond those found in the Code, the I.R.S. adds uncertainty to the administration of the tax law and raises the cost of exemption. The additional uncertainty and cost, in turn, may discourage otherwise-qualifying organizations from electing a tax regime that best reflects their pre-tax economics.

III. COMMUNITARIANISM IN THE UNITED STATES

Communal property ownership has deep roots in the United States. Even before European colonization of the Americas, most Native American nations' land ownership regimes had strong communal underpinnings.[111] Almost from the moment European settlers arrived in the Americas, they established communitarian living situations brought from their native countries.[112] Early communal groups in the American colonies found their basis in European religious dissent.[113] In the face of persecution, these religious dissenters joined the early waves of migrations to North America.[114] Their reading of the Bible convinced them that, as a body of believers, they needed to "practice[] common ownership of property, common

benefit of the members, as well as a common interest in the community treasury and property."); *see also infra* notes 236, 242 and accompanying text.

[110] None of this means to suggest that society should allow communitarian organizations to violate the law and fundamental public policy as they wish. If, however, society regards polygamy as violating public policy, it should be regulated directly. The purpose of section 501(d) is to provide a taxation scheme that reflects the economics of communitarian organizations, irrespective of whether society likes what they do. *See supra* Part II.B. There is no reason to revive and impose a vestigial public policy requirement on one specific business form.

[111] Julian C. Juergensmeyer & James B. Wadley, *The Common Lands Concept: A "Commons" Solution to a Common Environmental Problem*, 14 NAT. RESOURCES J. 361, 371–72 (1974) ("[N]early all [Native American tribes] contained a strong element of communal ownership, the progenitor of the common lands concept.").

[112] Donald F. Durnbaugh, *Communitarian Societies in Colonial America*, *in* AMERICA'S COMMUNAL UTOPIAS 14, 15 (Donald E. Pitzer ed., 1997).

[113] *Id.*

[114] *Id.*

production of goods, and common use of all things."[115]

The early nineteenth century saw a flourishing of communal groups, including such prominent groups as the Shakers, the Harmony Society, and the Oneida Community.[116] By the twentieth century, communal religious groups had become

> less prominent, less publicly visible, than their illustrious predecessors had been. No communal situation in the twentieth century . . . was as flamboyant as that of the hundreds of Oneidans living in complex marriage or the thousands of Shakers living celibately in a score of tidy, quaint villages had been.[117]

Even with their lowered profiles, however, dozens of Christian communal groups, including the Hutterites and the Shakers, continued into the twentieth century.[118] And the early twentieth century saw the birth of additional religious communitarian groups, though these groups often became known for attributes other than their communitarianism. For example, in 1903, Benjamin Purnell founded the Israelite House of David.[119] The Israelite House of David came to be known as much for its Eden Springs Amusement Park, its baseball teams, and its bands, as for its communitarian religious ethos.[120] The twentieth century also saw the formation of the FLDS church.[121] In the 1920s, a group of Mormon dissenters organized a new movement that "relied on early Brigham Young doctrines of communalism and plural marriage."[122]

Not all early-twentieth-century religious communitarian groups were Christian, however. The late nineteenth and early twentieth

[115] *Id.* at 14. Christian utopians found the basis for their communitarianism in the early Apostolic church, where "[a]ll who believed were together and had all things in common; they would sell their possessions and goods and distribute the proceeds to all, as any had need." *Acts* 2:44–45. Their sense of community caused, "the whole group of those who believed [to be] of one heart and soul, and no one claimed private ownership of any possessions, but everything they owned was held in common." *Acts* 4:32. These utopian religious dissenters intended to reproduce the economics of the Apostolic church. *See* Karl J.R. Arndt, *George Rapp's Harmony Society*, *in* AMERICA'S COMMUNAL UTOPIAS 57, 60 (Donald E. Pitzer ed., 1997) ("Rapp, like the leaders of the Moravians, Seventh Day Baptists, and Shakers, was influenced by the description of first-century Christian communal practices in Acts 2 and 4.").

[116] MILLER, QUEST FOR UTOPIA, *supra* note 9, at xi.

[117] *Id.* at xvii.

[118] *Id.* at 1.

[119] CLARE E. ADKIN, BROTHER BENJAMIN: A HISTORY OF THE ISRAELITE HOUSE OF DAVID 2 (1990).

[120] MILLER, QUEST FOR UTOPIA, *supra* note 9, at 81.

[121] Bennion, *supra* note 4, at 103–04.

[122] *Id.* at 102.

centuries, for example, saw the formation of a number of new African American religions known as "black Judaism."[123] Two of these groups—the Church of God and Saints of Christ and the Temple of the Gospel of the Kingdom—involved communal living.[124] The Vendanta Society, part of the Ramakrishna movement, also established a number of communal colonies in the United States in the early twentieth century.[125]

As the twentieth century continued, communal groups continued to multiply and their ideological foundations diversified. Not only did communalism expand beyond Christians trying to reproduce first-century Christian economics, it also expanded beyond merely religious communities. The 1930s "saw hundreds of new communities emerge, many of them the fruit of government depression-fighting programs."[126] Various "socialists, anarchists, cranks, visionaries, and other idealists" continued creating and running communitarian groups.[127] Communal groups began a shift toward "less rigid governing structures and lifestyle regulations."[128] As they became less rigid about governance and lifestyle, they also became less rigid about property ownership, allowing their members a mix of communal and personal forms of ownership.[129]

After a lull in communitarian communities during World War II, the late 1940s and 1950s saw a resurgence in communal experiments.[130] Intentional communities pushed back against the post-war urbanization of America.[131] Many of these 1950s intentional communities were loosely affiliated under the auspices of the Fellowship of Intentional Communities.[132] Economically, these groups "ranged from fully communal, with members living from a common purse, to land-trust situations in which family finances were largely private"; religiously and philosophically, they included groups as diverse as Quaker, Protestants, and secular individuals.[133]

123 MILLER, QUEST FOR UTOPIA, *supra* note 9, at 84–85.

124 *Id.* at 85–86. In spite of its name, the Church of God and Saints of Christ, "[t]itular nomenclature notwithstanding . . . had substantial Jewish content from the first." *Id.*

125 *Id.* at 91–93.

126 *Id.* at 121.

127 *Id.*

128 *Id.* at 156.

129 MILLER, QUEST FOR UTOPIA, *supra* note 9, at 156.

130 *Id.* at 162.

131 *Id.* at 163.

132 *Id.* at 163–64.

133 *Id.* at 164.

The 1960s marked a new resurgence in communalism.[134] In 1965, with the founding of Colorado's Drop City, "the new genre of the hippie commune became fully formed."[135] Rather than pursuing a common religious or philosophical path, Drop City brought together many of the mid-twentieth-century communitarian themes: "anarchy, pacifism, sexual freedom, rural isolation, interest in drugs, [and] art."[136] The Drop City economy, though poor, was truly communal, with new residents contributing their money (if they had any) to a common fund, and with residents sharing all other property, too.[137]

After Drop City, hippie communes began to spread, especially in California, northern New Mexico, and on the East Coast from Virginia north through New England.[138] The ascendance of hippie communes did not, of course, mark the end of earlier communal groups,[139] though hippies may have been largely unaware of their communitarian forebears.[140]

Even today, new forms of communitarian living continue to emerge. For example, as baby boomers start to reach retirement age, many search for a different kind of retirement from their parents.[141] Rather than ending up in a traditional nursing home, or trying to maintain their independence alone in their own homes, an increasing number opt to live in intentional communities.[142] These communities engage in communal living to one degree or another—at the very least, the residents eat and act together, and often put money into a common fund to pay for their expenses.[143]

Communitarians today tend to be less isolationist than previous

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134 TIMOTHY MILLER, THE 60S COMMUNES: HIPPIES AND BEYOND 17 (1999) [hereinafter MILLER, THE 60S COMMUNES].

135 *Id.*

136 *Id.* at 31.

137 *Id.* at 35.

138 *Id.* at 41.

139 *Id.* at 8 ("It is also important to realize that earlier American communitarianism had not ground to a halt when the new generation of communes appeared so visibly on the scene.").

140 MILLER, THE 60S COMMUNES, *supra* note 134, at 1 ("[M]any hippies . . . were not consciously interested in history, seeing themselves as new people creating a whole new social order independent of the past.").

141 *See, e.g.*, Elaine Louie, *Till Death (or Decorating Disputes) Do Us Part*, N.Y. TIMES, Sep. 19, 2013, at D1 ("[Cheesecake] was one of a number of such experiments, known as cohousing communities, that were springing up around the country at the time, based on a Danish model developed in the 1960s."); Elaine Louie, *Retirement? For 11 Friends It's Off to Camp*, N.Y. TIMES, Jan. 6, 1994, at C1 (communally-owned retirement location).

142 Louie, *Till Death (or Decorating Disputes) Do Us Part, supra* note 141, at D1.

143 *Id.*

generations.[144] This more accommodating posture allows a wide range of purposes and goals. Beyond religious and countercultural communes, communal structures potentially provide a utopia for retirees and others who have needs or desires that standard capitalist society does not meet.

IV. THE DEVELOPMENT OF SECTION 501(D)

A. *Communitarian Religious Groups v. the Income Tax*

During the first decade of the modern federal income tax, the Bureau of Internal Revenue—predecessor to the I.R.S.—asserted tax deficiencies against several communitarian religious groups. The Israelite House of David and two Hutterite groups proceeded to sue the Bureau of Internal Revenue, asserting they were exempt from taxation. Ultimately, all three groups lost, with the courts uniformly holding that they failed to qualify as exempt from taxation.

The district court's decision in *Israelite House of David v. Holden*[145] ultimately provides no insight into why the Bureau determined that the Israelite House of David did not qualify for a tax exemption. Believing that it qualified for an exemption from taxes, the Israelite House of David sued to enjoin the Bureau from imposing or collecting taxes from it, as well as for a refund of taxes, interest, and penalties it had paid.[146] Rather than addressing the substance of the Israelite House of David's claims, though, the court dismissed the case on jurisdictional grounds.[147] The court held that the Tax Anti-Injunction Act prevented it from hearing any "suit for the purpose of restraining the assessment or collection of any tax."[148] It also held that, as a court of equity, it could not hear the portion of the Israelite House of David's suit demanding a refund of taxes, interest, and penalties paid.[149] The court thus dismissed the suit without addressing the merits.

In two cases concerning the Hutterites, on the other hand, the courts did discuss the merits of the Bureau of Internal Revenue

[144] JOSEPH C. MANZELLA, COMMON PURSE, UNCOMMON FUTURE 170 (2010) ("Today's communitarians tend to avoid the pitfalls of choosing between hypermodernity and their community by not so much rejecting the outside world as rejecting the more egregious parts of it, such as excessive materialism and waste, while incorporating those aspects that are helpful.").

[145] Israelite House of David v. Holden, 14 F.2d 701 (W.D. Mich. 1926).

[146] *Id.* at 702.

[147] *Id.* at 703.

[148] *See* 26 U.S.C. § 7421(a) (2012) (current codification of the Tax Anti-Injunction Act); *Israelite House of David*, 14 F.2d at 702–03.

[149] *Israelite House of David*, 14 F.2d at 702.

position, holding that Hutterite corporations did not qualify for tax exemption. Those cases provide insight into why the Bureau—and ultimately the courts—were uncomfortable with permitting communitarian religious groups to claim an exemption from tax.

The Hutterites, a branch of the Anabaptists, trace their origins to 1528, and began migrating from the Ukraine to the United States in the 1870s.[150] Initially, the Hutterites established three colonies in South Dakota; today, the religion has grown to more than 350 colonies throughout North America.[151] A communitarian group, the Hutterites eschew personal property, following the early Christian church in holding property communally.[152] Effectively, this means that all property in a Hutterite colony belongs to the church, not to the individual believers.[153] The church then allocates a monthly allowance, furniture, food, clothing, and other necessities, to individuals in accordance with their need.[154] Individuals have the right to use these goods, but do not actually own them.[155] Ultimately, while individual Hutterites may not have any significant personal property, the church's allocation functions as a "cradle-to-the-grave social security system."[156]

In 1897, the Hutterites formed Hutterische Gemeinde Elmspring, a South Dakota corporation.[157] In 1917 (the year at issue in the case), Hutterische Gemeinde Elmspring consisted of four colonies and engaged in various agricultural pursuits, including raising wheat, rye, oats, corn, cattle, hogs, horses, sheep, and poultry.[158] It owned farmland, farm implements, flour mills, "blacksmith shops, broom works, harness and shoe shops, and a bakery."[159] It earned net income of $145,969.50 in 1917, which it used to support its members, maintain its property, and to purchase additional property.[160] Hutterische

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150 MILLER, QUEST FOR UTOPIA, *supra* note 9, at 7.

151 *Id.*

152 Alvin Esau, *Communal Property and Freedom of Religion: Lakeside Colony of Hutterian Brethren v. Hofer*, *in* RELIGIOUS CONSCIENCE, THE STATE, AND THE LAW: HISTORICAL CONTEXTS AND CONTEMPORARY SIGNIFICANCE 97, 101 (John McLaren & Harold Coward eds., 1999).

153 *Id.* at 100–01.

154 Hanna Kienzler, *Communal Longevity: The Hutterite Case*, 100 ANTHROPOS 193, 202 (2005).

155 *Id.* Individuals do, however, own goods they purchase with their monthly allowance. *Id.*

156 Pierre L. van den Berghe & Karl Peter, *Hutterites and Kibbutzniks: A Tale of Nepotistic Communism*, 23 MAN 522, 532 (1988) [hereinafter van den Berghe & Peter].

157 Hofer v. United States, 64 Ct. Cl. 672, 682 (1928).

158 *Id.* at 673.

159 *Id.*

160 *Id.*

Gemeinde Elmspring claimed exemption under the Revenue Act of 1916 as a "[c]orporation . . . organized and operated exclusively for religious, charitable, scientific, or educational purposes, no part of the net income of which inures to the benefit of any private stockholder or individual."[161]

The court found two significant deficiencies in Hutterische Gemeinde Elmspring's claim that it met the exemption requirements. First, the corporation clearly violated the no-private-inurement requirement. In fact, it used a significant portion of its profits specifically for the support and maintenance of its members.[162] Second, given its extensive business activities, it failed the "operated exclusively for religious purposes" test.[163] As a result of its failure to meet these two requirements, the court held that Hutterische Gemeinde Elmspring did not qualify as a tax-exempt public charity, and thus owed taxes on its income.[164]

The Board of Tax Appeals came to a similar conclusion regarding Hutterische Bruder Gemeinde. The Hutterites incorporated Hutterische Bruder Gemeinde in South Dakota in 1905.[165] Hutterische Bruder Gemeinde had no capital stock or shareholders; instead, its members were individuals who "subscribed to the religious beliefs and practices" of the Hutterites.[166] Upon joining, members had to transfer their property to Hutterische Bruder Gemeinde, and, after transferring their property, subsequently began to work for the corporation.[167] Among other things, the corporation produced agricultural products and owned and operated grist mills, a broom factory, a machine shop, a carpenter shop, and a ferryboat.[168] It sold products that it produced to the public at market prices.[169] In compensation for members' work in its various endeavors, Hutterische Bruder Gemeinde provided them with necessities.[170]

Like the claims court, the Board of Tax Appeals found that

161 *Id.* at 683. This language is substantially similar to the current Code's exemption for public charities. *See* I.R.C. § 501(c)(3) (2015) ("Corporations . . . organized and operated exclusively for religious, charitable, scientific, testing for public safety, literary, or educational purposes . . . no part of the net earnings of which inures to the benefit of any private shareholder or individual . . . .").

162 *Id.* at 684.

163 *Hofer*, 64 Ct. Cl. at 684.

164 *Id.* at 683.

165 Hutterische Bruder Gemeinde v. Comm'r, 1 B.T.A. 1208, 1208 (1925).

166 *Id.*

167 *Id.* at 1208–09.

168 *Id.* at 1209.

169 *Id.*

170 *Id.*

Hutterische Bruder Gemeinde failed to qualify as a charitable endeavor. Its profits, the Board found, did not provide benefits to the general public.[171] Rather, the profits went solely to support the corporation's members.[172] The Board also looked at the scope of Hutterische Bruder Gemeinde's commercial activities—10,000 acres of farmland, producing far more than the members themselves needed—and the fact that it sold the surplus to the general public at the prevailing market rate.[173] Its activities, the Board held, were carried on both for profit and in direct competition with other citizens.[174] Even if Hutterische Bruder Gemeinde was originally formed for religious purposes, it failed to prove that it was operated exclusively for religious purpose.[175] It therefore failed to qualify for an exemption from taxation.

These communitarian religious organizations did not only face the corporate income tax, however. Because their members could not hold property individually, the organizations could not distribute their income to members. Instead, communitarian religious organizations would have to hold their profits in excess of the costs associated with their businesses and the costs of supporting their members. But if they failed to distribute their income, they would have to pay an undistributed earnings tax on top of the corporate income tax they had already paid.[176] It was against this backdrop that Congress passed its targeted exemption of communitarian religious and apostolic organizations.

B. *Tax-Exempt Organizations*

The best known exempt organizations are the public charities and private foundations exempt under section 501(c)(3). These include,

[171] *Hutterische Bruder Gemeinde*, 1 B.T.A. at 1211.

[172] *Id.*

[173] *Id.*

[174] *Id.* The fear of unfair competition between tax-exempt entities and taxable entities engaged in the same business led to Congress enacting the unrelated business income tax. *See* Samuel D. Brunson, *Repatriating Tax-Exempt Investments: Tax Havens, Blocker Corporations, and Unrelated Debt-Financed Income*, 106 NW. U. L. REV. 225, 232 (2012) [hereinafter Brunson, *Tax Havens*].

[175] *Hutterische Bruder Gemeinde*, 1 B.T.A. at 1212.

[176] *See* Meade Emory & Lawrence Zelenak, *The Tax Exempt Status of Communitarian Religious Organizations: An Unnecessary Controversy?*, 50 FORDHAM L. REV. 1085, 1110 (1982). To the extent a corporation accumulated profit in excess of its reasonable needs, it became subject to the accumulated earnings tax in addition to the corporate income tax it paid when it earned its income. *See, e.g.*, Jeffrey L. Kwall, *Subchapter G of the Internal Revenue Code: Crusade Without a Cause?*, 5 VA. TAX REV. 223, 235 (1985); Homer L. Elliot, *The Accumulated Earnings Tax and the Reasonable Needs of the Business: A Proposal*, 12 WM. & MARY L. REV. 34, 35–36 (1970) [hereinafter Emory & Zelenak].

among other things, churches, universities, museums, some hospitals, and the NCAA.[177] The tax law also exempts, among other types of organizations, social welfare organizations,[178] non-profit credit unions,[179] labor unions,[180] and even the National Football League.[181]

As a general rule, none of these organizations pays taxes on its income.[182] The Code provides public charities and private foundations with one significant advantage over other tax-exempt entities, however: not only are they exempt from taxation,[183] but donors to public charities can deduct from their taxable income the value of their donations to the charity.[184] For example, in 2016, a married couple filing a joint return with taxable income of $100,000 pays $16,542.50 of federal income tax.[185] If the couple makes a deductible donation of $10,000 to a public charity, however, that reduces the couple's tax liability by $2,500, and the government only receives $14,042.50.[186] And because the public charity has no tax liability, the government does not recoup the lost revenue. Under this double benefit, then, public charities avoid paying taxes on their income,[187] while the

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177 I.R.C. § 501(c)(3) (2015); *see also* Brigham Daniels, *When Agencies Go Nuclear: A Game Theoretic Approach to the Biggest Sticks in an Agency's Arsenal*, 80 GEO. WASH. L. REV. 442, 456 (2012) ("Tax-exempt organizations constitute some of society's most revered and important institutions: churches, universities, hospitals . . . museums, and other organizations built to serve the needs of the poor, advance the arts, and educate society.").

178 I.R.C. § 501(c)(4) (2015). The recent Supreme Court case, *Citizens United v. Federal Election Commission* has probably made Citizens United the best-known of these exempt social welfare organizations. *See* Nikki Usher & Michelle D. Layser, *The Quest to Save Journalism: A Legal Analysis of New Models for Newspapers from Nonprofit Tax-Exempt Organizations to L3Cs*, 2010 UTAH L. REV. 1315, 1356 (2010) ("Citizens United is a 501(c)(4) social welfare organization . . . .").

179 I.R.C. § 501(c)(14) (2015).

180 *Id.* § 501(c)(5).

181 *Id.* § 501(c)(6). Congress explicitly enacted an exemption for the NFL in 1986, ostensibly as a way of ensuring its "pension and merger arrangement would not endanger its exemption." I.R.S. Priv. Ltr. Rul. 83-210-94 (Feb. 26, 1983). The I.R.S. has read the specific provision broadly enough, however, to encompass other professional sports leagues. *Id.*

182 I.R.C. § 501(a) (2015).

183 *Id.* § 501(c)(3).

184 *Id.* § 170(a).

185 Rev. Proc. 2015-53 § 2.01, 2015-44 I.R.B. 615. The I.R.S. arrives at that number by subtracting $75,300 from $100,000, and multiplying the difference by 0.25. It then adds the product and $10,367.50.

186 *Id.*

187 One exception exists to public charities' exemption from taxation: under the unrelated business income tax, entities exempt under section 501(c)(3) nonetheless pay taxes on certain income they earn while engaged in for-profit business. *Id.*; I.R.C. § 511(a) (2012).

government collects less tax than it otherwise would from taxpayers who donate to public charities.

This double benefit is not available, however, to most tax-exempt organizations. With the exception of donors to public charities and a small handful of other tax-exempt organizations,[188] donors to tax-exempt organizations cannot deduct their donations.[189]

C. *Religious, Apostolic, and Exempt*

In 1936, Congress provided a special tax exemption specifically for communitarian religious organizations.[190] The sparse legislative history does not reveal Congress's motivation in enacting this exemption,[191] but it seems fair to assume that the Israelite House of David and Hutterite cases motivated and influenced the legislation. By the 1920s, the Israelite House of David—mentioned explicitly in the legislative history—had gained a national reputation.[192] That national reputation may have provided the Israelite House of David the institutional clout to convince legislators that, in light of their losses at the Bureau of Internal Revenue and the courts, these communitarian religious groups needed the legislation.[193]

The exemption provided to communitarian religious groups falls

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188 In addition to public charities and private foundations exempt under section 501(c)(3), the Internal Revenue Code permits deductions for certain donations made to states and their political subdivisions, war veteran organizations, fraternal organizations, and cemeteries. I.R.C. § 170(c) (2012).

189 New Colonial Ice Co. v. Helvering, 292 U.S. 435, 440 (1934) ("Whether and to what extent deductions shall be allowed depends upon legislative grace; and only as there is clear provision therefor can any particular deduction be allowed.").

190 Revenue Act of 1936, ch. 690, § 101(18), 49 Stat. 1648, 1675–76; *see also* IRM 7.25.23.2 (Feb. 23, 1999) (section 501(d) "dates back to the Revenue Act of 1936").

191 The full legislative history of the provisions consists of a single paragraph in the Congressional Record:

> It has been brought to the attention of the committee that certain religious and apostolic associations and corporations, such as the House of David and the Shakers, have been taxed as corporations, and that since their rules prevent their members from being holders of property in an individual capacity the corporations would be subject to the undistributed-profits tax. These organizations have a small agricultural or other business. The effect of the proposed amendment is to exempt these corporations from the normal corporation tax and the undistributed-profits tax, if their members take up their shares of the corporations' income on their own individual returns. It is believed that this provision will give them relief, and their members will be subject to a fair tax.

80 CONG. REC. 9074 (1936) (statement of Sen. Walsh).

192 ADKIN, *supra* note 119, at 79.

193 *Id.* at 46 n.71 ("If the system of taxation hadn't been changed [the Israelite House of David] would have gone out of business.").

closer to the exemptions for non-charities than to the exemption for public charities. To qualify for an exemption, section 501(d) requires that the communitarian religious group be organized as a corporation for tax purposes.[194] If it meets the requirements of section 501(d), it does not owe taxes on its income.[195] Like most other tax-exempt entities, however, donors cannot deduct their donations to exempt communitarian religious groups.[196]

A communitarian religious organization that wants to be exempt from taxes faces some additional, if ill-defined, qualification requirements as well. First, it must be a "religious or apostolic" organization.[197] Next, it must have a communal or community treasury used for the benefit of its members.[198] Finally, its members must include their share of the organization's income in *their* gross income for tax purposes.[199]

The only unambiguous exemption requirement is the requirement that the communitarian organization qualify as a corporation for tax purposes. The rest of the qualification requirements remain undefined and ambiguous. For example, although such an organization must "have a religious or apostolic character,"[200] the Code does not define what it means by "religious or apostolic." The limited legislative history also fails to define the terms, but it lists, as examples of religious and apostolic organizations, the Shakers and the Israelite House of David.[201] Even providing two examples of groups that presumptively qualify as "religious and apostolic" fails to provide a usable definition, though. It does not explain which shared qualities of these groups are central to their religious or apostolic nature—and are thus necessary for qualification purposes—and which are superfluous.[202] Even as it passed the

[194] I.R.C. § 501(d) (2015). Under the tax law, an association is a business entity that is neither disregarded nor treated as a partnership. Treas. Reg. § 301.7701-3(a) (2006). Ultimately, then, an association is a subset of a corporation. Treas. Reg. § 301.7701-2(b)(2) (2016).

[195] I.R.C. § 501(a), (d) (2015).

[196] *Id.* § 170(c) (2012) (definition of "charitable contribution" does not include contribution to religious and apostolic groups).

[197] *Id.* § 501(d) (2015).

[198] *Id.*

[199] *Id.*

[200] Kleinsasser *ex rel.* Kleinsasser v. United States, 707 F.2d 1024, 1029 (9th Cir. 1983).

[201] 80 Cong. Rec. 9074 (1936) (statement of Sen. Walsh) ("[C]ertain religious and apostolic associations and corporations, such as the House of David and the Shakers, have been taxed as corporations . . . .").

[202] For example, both groups were Christian. *See* MILLER, QUEST FOR UTOPIA, *supra*

legislation, Congress recognized the problematic nature of such an attempt as it considered the legislation.[203]

The common or community treasury requirement provides an additional layer of uncertainty.[204] As with the definition of "religious and apostolic," Congress failed to define what qualified as a common or community treasury.[205] The Tax Court has provided some gloss on the definition, holding that a common or community treasury means that "property of such organizations not be held by members individually but rather held in a 'community capacity' with all members having equal interests in the community property."[206] While the court's holding does not provide specific definitional contours, it goes on to explain that such treasuries should be used for the "maintenance and support" of the organization's members.[207] The court also held that a common or community treasury does not preclude members from also owning property apart from the organization; members of a religious or apostolic group do not, for example, have to take a vow of poverty.[208]

In enacting the exemption for religious and apostolic organizations, Congress expressly recognized that they would engage in business. The Code states that a qualifying organization can be exempt from tax "even if such associations or corporations engage in

note 9, at 80 ("Although the House of David was definitively shaped by Purnell himself, it did stand in a fairly well-established nonmainstream Christian tradition."); Priscilla J. Brewer, *The Shakers of Mother Ann Lee*, *in* AMERICA'S COMMUNAL UTOPIAS 37, 41 (Donald E. Pitzer ed., 1997) ("He was particularly impressed by the Shakers' practical Christianity . . . ."). Does "religious or apostolic" therefore limit the exemption to Christian communitarian groups? Additionally, both the Israelite House of David and the Shakers preached celibacy. ADKIN, *supra* note 119, at 34 ("The religious practice [of the Israelite House of David] that drew the most attention from the outside world was celibacy . . . ."); STEPHEN J. STEIN, THE SHAKER EXPERIENCE IN AMERICA 118 (1992) ("The [Shakers] condemned marriage, private property, the established churches, democracy, and individual freedom by advocating celibacy, common property, the superiority of their own society, the authority of the ministry, and submissive obedience."). Could "religious or apostolic"—a prerequisite for tax exemption under section 501(d)—possibly rest on members of the organization eschewing sex?

203 *See* Twin Oaks Community, Inc. v. Comm'r, 87 T.C. 1233, 1244 (1986) ("[W]e note that the term 'religious or apostolic associations or corporations' is itself not defined in the statute, although Senator La Follette pointed out to Senator Couzens the inherent definitional problems."), *acq.*, 1987-2 C.B. 1.

204 I.R.C. § 501(d) (2015).

205 *Twin Oaks Community, Inc.*, 87 T.C. at 1247 ("[W]e find it difficult to view Senator Walsh's comment as defining . . . the terms 'common treasury' or 'community treasury.'").

206 *Id.* at 1248.

207 *Id.*

208 *Id.* at 1249.

business for the common benefit of the members."[209] With this language, Congress effectively overrode the "several court decisions [that] had denied exempt status to religious communities that operated commercial businesses, primarily on the theory that the operation of the business constituted a substantial non-exempt purpose."[210] While today, with the unrelated business income tax, the tax law recognizes that even exempt organizations can sometimes engage in business ventures,[211] the inclusion in section 501(d) of an explicit authorization to do so signals that section 501(d) operates differently from other exemptions. That is, section 501(d) does not exempt religious and apostolic organizations from tax because society has decided that they are not the kind of organizations that pay taxes. Instead, religious and apostolic organizations are exempt from tax because an exemption better reflects the economics of these organizations.[212]

Notwithstanding the Code's exemption of religious and apostolic organizations from paying taxes, their income does not go entirely untaxed. Rather, members must include their "pro rata shares" (however defined) of the organization's income in their own gross income, whether or not the organization distributes its income.[213] The Code treats such deemed or actual distributions as dividends received by the members.[214] Members cannot treat their inclusions as qualified dividend income, eligible for preferential long-term capital gain rates, though.[215] Instead, they pay taxes on their pro rata share of the religious or apostolic organization's income at their ordinary marginal

[209] I.R.C. § 501(d) (2015).

[210] Emory & Zelenak, *supra* note 176, at 1109–10; *see supra* notes 162–175 and accompanying text.

[211] Emory & Zelenak, *supra* note 176, at 1110 ("With the addition of [the unrelated business income tax], the Service recognized that operation of a trade or business is not a bar to exempt status if the organization 'is not organized or operated for the primary purpose of carrying on an unrelated trade or business . . . .'").

[212] *See infra* notes 239–242 and accompanying text. Secondarily, the special tax treatment recognizes that, while communitarian organizations operate in a market economy, their existence is premised on nonmarket considerations. These nonmarket considerations "include friendship, affection, altruistic behavior, a sense of commitment or belongingness, and family ties." Tsilly Dagan, *Itemizing Personhood*, 29 VA. TAX REV. 93, 95 (2009). By default, though, the tax law seeks to limit itself to the market sphere. *Id.* By enacting section 501(d), Congress recognized that religious and apostolic organizations operated outside of the normal market-oriented world that it designed the tax law to capture.

[213] I.R.C. § 501(d) (2015).

[214] *Id.*

[215] *Id.* § 1(h)(11)(B)(ii)(I) (2014) (excluding from the definition of "qualified dividend income" income paid by corporations exempt from tax under section 501).

tax rates.[216]

Effectively, the tax regime applicable to religious and apostolic organizations differs significantly from the regime that governs public charities and private foundations. Unlike the income of any other tax-exempt organization, the income of religious and apostolic organizations ultimately faces taxation. Although the organization avoids paying taxes, its members must include their pro rata share of its income in their gross income.[217] In addition, the Code does not provide any deduction for donors to religious and apostolic organizations.[218] Ultimately, the "exemption" for religious and apostolic organizations functions more like a pass-through (or quasi-pass-through) regime than an exemption for public charities.[219]

The inclusion of the special tax regime for religious and apostolic organizations among tax-exempt organizations should not matter; the tax law is clear that economically they function as quasi-pass-through entities. In spite of the law's clarity, though, the I.R.S. appears to have been blinded by its association with tax-exemptions.[220] To prevent this mischaracterization in the future, Congress should remove the regime from section 501 of the Code and, instead, clarify that religious and apostolic organizations are not exempt, and thus not subject to the general rules of tax exemption.

V. OTHER TAX REGIMES ARE POOR MATCHES FOR THE ECONOMICS OF COMMUNITARIAN ORGANIZATIONS

While Congress crafted section 501(d) to reflect the economic realities of communitarian organizations, its uniqueness may make it superfluous. If section 501(d) serves no distinct purpose that could not be served equally well by a different and broader tax regime,[221] it should be repealed and communitarian organizations should be taxed under that broader tax regime. On the other hand, if no alternative

216 A high-income member of an exempt religious or apostolic organization may have her tax liability on the deemed dividends increased by 3.8 percentage points. *Id.* § 1411(a). The amount of dividends from the religious or apostolic organization—deemed or not—would not increase their net earnings from self-employment for purposes of the Self-Employment Contributions Act, however. Rev. Rul. 58-328, 1958-1 C.B. 327.

217 I.R.C. § 501(d) (2015).

218 *See id.* § 170(c)(2) (2012) (listing organizations, donations to which qualify as deductible charitable contributions).

219 *See infra* notes 236–242.

220 *See supra* Part II.

221 *See, e.g.*, Emory & Zelenak, *supra* note 176, at 1110 ("[S]ection 501(d) may have lost most of its importance since the enactment of the unrelated business income tax.").

tax regime accurately reflects the economics of communitarian groups, section 501(d) serves a purpose that justifies both its continued existence and efforts to improve and expand its reach. To determine whether section 501(d) has become superfluous, then, we must examine if another tax regime accurately captures the unique economics of communitarian organizations.

A. *Corporate Taxation*

Without section 501(d), religious and apostolic organizations would be treated as corporations for tax purposes.[222] The federal tax law imposes two levels of tax on corporate income. First, a corporation pays taxes on its taxable income at marginal rates of up to thirty-five percent.[223] Second, shareholders pay taxes on the corporate income when the corporation distributes that income in the form of dividends.[224]

Although the modern corporate income tax was originally enacted in the early twentieth century,[225] economists generally agree that it hurts the economy.[226] Still, the corporate income tax continues to exist and appears unlikely to go away.[227] Because it exists, and because without section 501(d), communitarian organizations would be taxed as corporations, we must evaluate whether the corporate tax treatment would constitute an acceptable fit for communitarian organizations.

In spite of the corporate income tax's economic inefficiencies, its existence finds some support in tax policy. The two principal policy justifications for the corporate income tax are a regulatory theory and a shareholder theory.[228] The regulatory theory dates back to the

[222] *See, e.g.*, Kleinsasser *ex rel.* Kleinsasser v. United States, 707 F.2d 1024, 1025–26 (9th Cir. 1983) ("Without § 501(d), the income of a religious [or apostolic] corporation . . . would be subject to the regular corporate income tax . . . . .").

[223] I.R.C. § 11(a)–(b) (2012).

[224] *Id.* § 301(a), (c) (2014).

[225] STEVEN A. BANK, FROM SWORD TO SHIELD: THE TRANSFORMATION OF THE CORPORATE INCOME TAX, 1861 TO PRESENT 1 (2010).

[226] MARTIN A. SULLIVAN, CORPORATE TAX REFORM: TAXING PROFITS IN THE 21ST CENTURY 25 (2011) ("[O]f all the bad taxes out there, economists consider the corporate tax the most harmful to economic growth."). Among other problems, the corporate income tax distorts business decisions, including the choice of business form, of retaining or distributing earnings, and of debt or equity financing. BANK, *supra* note 225, at xii–xiv.

[227] *See* MARTIN A. SULLIVAN, CORPORATE TAX REFORM: TAXING PROFITS IN THE 21ST CENTURY 34–35 (2011).

[228] Philip T. Hackney, *What We Talk About When We Talk About Tax Exemption*, 33 VA. TAX REV. 115, 118 (2013).

corporate excise tax of 1909.[229] In essence, the corporate income tax seeks to align the actions of managers with the interests of shareholders where the managers and shareholders may be different people.[230]

By contrast, the shareholder theory of corporate taxation sees the corporate tax as a means to tax the income of shareholders. Imposing this additional tax on shareholders is justified on ability-to-pay grounds: presumably, by virtue of their owning corporate shares, shareholders have sufficient wealth to bear these taxes.[231]

Neither of these policy considerations applies to communitarian organizations, however. Members of communitarian organizations do not have an ownership interest in the organization. In fact, most eschew, fully or partially, the idea of privately-held property in favor of holding property together.[232]

Without shareholders, communitarian organizations do not have a separation between ownership and management that requires regulation. Without shareholders, the managers of communal property only have to concern themselves with the good of the organization.

Moreover, without shareholders, an entity-level tax cannot function as an additional tax on shareholder income. In fact, the unique structure of section 501(d) does a better job of taxing members of religious and apostolic organizations than the corporate income tax would: it directly taxes individuals on entity-level income in the year the entity earns that income.

In addition to the policy considerations underlying the continued existence of the corporate income tax, as a practical matter, it may be necessary. The federal government uses the corporate income tax to raise significant revenue. In 2015, the federal government raised more than $389 billion—or almost twelve percent of its gross collections—from corporate taxes.[233] In addition, it prevents individual taxpayers

229 Marjorie E. Kornhauser, *Corporate Regulation and the Origins of the Corporate Income Tax*, 66 IND. L.J. 53, 53 (1990) ("The Corporate Excise Tax of 1909 reflects the Progressive Era's attempts to regulate corporations . . . .").

230 Hackney, *supra* note 228, at 141–42.

231 *Id.* at 140. The shareholder theory of corporate taxation grounds itself in questionable assumptions. Though the incidence of corporate income taxation is still debated, it does not fall solely on shareholders. Among others, labor and consumers might bear some portion of the corporate income tax. Reuven S. Avi-Yonah, *Corporations, Society, and the State: A Defense of the Corporate Tax*, 90 VA. L. REV. 1193, 1203 n.34 (2004).

232 *See supra* notes 111–115 and accompanying text.

233 I.R.S., 2015 DATA BOOK 3 tbl.1 (2015), https://www.irs.gov/pub/irs-soi/15databk.pdf.

from using the formal separation between corporations and shareholders to defer or evade taxes.[234]

As a practical matter, however, these revenue considerations do not provide a compelling reason to tax communitarian organizations under the corporate income tax. Section 501(d) does not permit the deferral or evasion of taxes. In addition, because of the relative scarcity of communitarian organizations and because deemed dividends from religious and apostolic organizations do not qualify for preferential tax rates,[235] eliminating the entity level of taxation will not significantly reduce federal revenue.

B. *Partnership Tax*

While qualifying religious and apostolic organizations do not pay taxes,[236] their exemption has a materially different function from other tax exemptions. Notably, the revenue earned by religious and apostolic organizations does not escape taxes altogether. Rather, members must include in their gross income their pro rata share of the organization's taxable income, whether or not the organization distributes that income.[237] In addition, the exemption under section 501(d) does not provide any deduction to members—or other taxpayers—who donate to exempt religious and apostolic organizations.[238]

In fact, for tax purposes, religious and apostolic organizations look more like partnerships than like tax-exempt public charities. Like religious and apostolic organizations, partnerships do not pay taxes on

[234] SULLIVAN, *supra* note 226, at 35–36. For example, if corporate income went untaxed, an individual who owned a portfolio of dividend—and interest—paying securities could incorporate a holding company and transfer her securities to the holding company in exchange for shares of the holding company. Because the incorporated holding company is a different person than the shareholder, she would no longer be taxable on the income from her portfolio. At the same time, without a corporate income tax, the holding company would not be taxable on the income from the portfolio. The shareholder could still benefit from her investment, though. As the sole shareholder, she could cause the holding company to pay dividends of some portion of the return, though she would pay taxes on the dividends received. Alternatively, if she wanted to avoid taxation altogether, she could cause the corporation to lend her money, or she could borrow from a third party using her shares in the corporation as collateral.

[235] I.R.C. § 1(h)(11)(B)(ii) (2012).

[236] *Id.* § 501(a) (2015) ("An organization described in subsection . . . (d) . . . shall be exempt from taxation under this subtitle . . . .").

[237] *Id.* § 501(d).

[238] Lewis D. Solomon & Kimberly J. Benjamin, *Intentional Communities: A Primer*, 23 OHIO N.U. L. REV. 143, 188 (1996) ("[A] 501(d) organization cannot confer tax deductions for donations.").

their income.[239] Instead, the partnership's gains and losses pass through to each partner, who must take into account her distributive share of such gains and losses in calculating her tax.[240] In addition, much like members of religious and apostolic organizations, a partner must include in her income her distributive share of partnership income whether or not the partnership actually distributes that income.[241] In fact, exempt religious and apostolic organizations appear to file the same information tax return as partnerships.[242] If the partnership tax regime reflected the economics of communitarian organizations, then it might make sense to repeal section 501(d) and tax religious and apostolic organizations using subchapter K.[243] By eliminating section 501(d), Congress could simplify the tax law.

Congress enacted subchapter K to remedy the confusing tax treatment of partners and partnerships that existed prior to 1954 and to replace it with a regime that provided "simplicity, flexibility, and

[239] I.R.C. § 701 (2012) ("A partnership as such shall not be subject to the income tax imposed by this chapter.").

[240] *Id.* § 702(a) (2003).

[241] Treas. Reg. § 1.702-1(a) (1956) ("Each partner is required to take into account separately in his return his distributive share, whether or not distributed, of each class or item of partnership income, gain, loss, deduction, or credit . . . .").

[242] The basis for religious and apostolic organizations' requirement to file a partnership return is not currently clear. From 1948 until 1971, the Treasury regulations mandated it. *See* I.R.S. Priv. Ltr. Rul. 94-34-002 (Apr. 5, 1994). The 1971 revision to the regulations removed the explicit requirement, though it is not clear what the revised regulations intended with respect to religious and apostolic organizations. *Id.* Still, though the regulations no longer state an explicit requirement that religious and apostolic organizations file a partnership return, they do provide that such an organization needs to file a Form 1065 within four months and fifteen days of the close of its taxable year. Treas. Reg. § 1.6033-2(e) (as amended in 2015). Form 1065 is the information return partnerships are also required to file. *See* Treas. Reg. § 1.6031(a)-1(a)(1) (as amended in 2005) (requiring partnership to file partnership return); I.R.S. Instructions for Form 1065, 2 (2012) ("Form 1065 is an information return used to report the income, gains, losses, deductions, credits, etc., from the operation of a partnership."). The instructions to Form 1065 state that religious and apostolic organizations must file a Form 1065. *Id.* at 3. But instructions to tax forms are not binding authority, and their use as such would create significant administrative law problems. Armstrong v. Comm'r, 139 T.C. 468, 484 (2012), *aff'd*, 745 F.3d 890 (8th Cir. 2014). Still, even without binding authority, it makes sense for religious and apostolic organizations to file a partnership return, notwithstanding the fact that they are not partnerships for tax purposes. I.R.S. Priv. Ltr. Rul. 94-34-002 ("Regardless of whether the current regulations are read as mandating the use of Form 1065 . . . filing as a partnership did not confer partner status on the members.").

[243] Subchapter K of the Code governs the taxation of partnerships. Philip F. Postlewaite et al., *A Critique of the ALI's Federal Income Tax Project—Subchapter K: Proposals of the Taxation of Partners*, 75 GEO. L.J. 423, 424–25 (1986) ("Subchapter K of the Internal Revenue Code . . . currently houses sections 701-761, the primary provisions addressing partnership taxation.").

equity as between partners."[244] To achieve this simplicity, flexibility, and equity, subchapter K essentially treats the partnership as a conduit rather than a taxpayer.[245] Over the years, Congress has encrusted this simple conduit approach with various rules to impede partners from shifting tax attributes, including income and deductions, in ways Congress considers unacceptable.[246]

Though section 501(d) also functions to provide simplicity, flexibility, and equity to members of religious and apostolic organizations, Congress did not design it with the same conduit theory in mind. Under the conduit taxation of partnerships, for example, partnerships pass through to their partners not only a specific amount of income, but the character of the income.[247] Assume, for example, that a partnership earns $100 during the taxable year. Half of its income consists of interest, taxable at ordinary rates. The other half it earns from selling a capital asset it has held for longer than a year, which means it will be taxed at long-term capital gains rates.[248] A partner with a ten percent interest in the partnership will receive an allocation of $10; $5 of that amount will be ordinary income, and $5 will be long-term capital gain.[249]

Religious and apostolic organizations, on the other hand, do not pass the character of their income through to their members. Rather, members must treat their allocations as dividends, irrespective of the actual source.[250] Under current tax law, qualified dividends are taxed at the lower long-term capital gains rates.[251] If the deemed dividends

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244 H.R. REP. No. 1337, at 65 (1954).

245 Philip F. Postlewaite, *I Come to Bury Subchapter K, Not to Praise It*, 54 TAX L. 451, 452–53 (2001) ("Under Subchapter K, partnerships are subjected to conduit taxation, *i.e.*, the enterprise is largely ignored for tax purposes and its owners are subjected to a single level of taxation, with maximum flexibility among the partners to order their financial affairs.").

246 *See* Lawrence Lokken, *Taxation of Private Business Firms: Imagining a Future Without Subchapter K*, 4 FLA. TAX REV. 249, 250 (1999); *see also* Noël B. Cunningham & James R. Repetti, *Textualism and Tax Shelters*, 24 VA. TAX REV. 1, 5 (2004) ("Oversimplified, the regulations assert that there is an overall legislative intent underlying subchapter K, and if a partnership is formed or availed of in connection with a transaction to substantially reduce federal taxes in a manner inconsistent with this intent, the transaction may be recast.").

247 *See* I.R.C. § 702(b) (2012); *see also* Treas. Reg. § 1.702-1(b) (1956).

248 *See* I.R.C. § 1222(3) (2012).

249 The difference is relevant to our taxpayer because ordinary income is taxable at a marginal rate of up to 39.6 percent, *id.* § 1(a)–(d), while long-term capital gain is taxable at a rate of not more than twenty percent. *Id.* § 1(h)(1)(D) (2014). For a sufficiently high-income partner, both rates would be increased by 3.8 percentage points. *Id.* § 1411(a).

250 *See* Treas. Reg. § 1.501(d)-1(a) (1958).

251 I.R.C. § 1(h)(11)(A) (2012).

from religious and apostolic organizations were qualified dividends, this dividend treatment would provide the same or better tax treatment to members of religious and apostolic groups than partners receive. In the prior example, rather than half the allocation being treated as ordinary income, the whole amount would be taxed at long-term capital gains rates. The tax law, however, excludes dividends paid (or deemed paid) by religious and apostolic organizations from the definition of qualified dividend income.[252] As a result, any long-term capital gains earned by the organization end up transformed into ordinary income in the hands of members.

This deemed dividend treatment also prevents members of religious and apostolic organizations from deducting losses suffered by the organization. Consistent with the theory that a partnership is merely a conduit for its partners, when a partnership suffers a loss, it cannot deduct that loss.[253] Instead, it passes its loss through to its partners.[254] If the loss qualifies as deductible (*e.g.*, it is incurred in the partnership's trade or business), the partners can then deduct the loss against their income.[255]

Congress did not provide religious and apostolic organizations with the ability to pass entity-level losses through to members of the organization. Instead, members receive a deemed dividend of their share of organization's taxable income.[256] If a religious or apostolic organization has losses, it can use them to reduce its taxable income, and thus reduce the deemed dividend to its members, but the members themselves cannot receive a distribution, deemed or otherwise, of a loss.[257]

Whatever Congress's reason for not providing pure conduit treatment to religious and apostolic organizations, this inability to pass losses through to its members puts those members of these communitarian groups at a disadvantage when compared to partners in a partnership, at least in certain circumstances. If, for example, a

[252] *Id.* § 1(h)(11)(B)(ii)(I).

[253] *Id.* § 701 (2012) ("Persons carrying on business as partners shall be liable for income tax only in their separate or individual capacities.").

[254] *Id.* § 702(a)(1)–(3) (partners take into account their distributive share of gains *and* losses).

[255] *See, e.g.*, *id.* § 162(a) (2012); § 212 (1954). The Code places certain limitations, however, on partners' ability to deduct partnership losses. *Id.* § 704(d) (2004).

[256] *Id.* § 501(d) (2015).

[257] Religious and apostolic organizations are not alone among quasi-pass-through entities that cannot pass losses through. Regulated investment companies can also use losses to reduce their investment company taxable income, but cannot pass those losses through to shareholders. Samuel D. Brunson, *Mutual Funds, Fairness, and the Income Gap*, 65 ALA. L. REV. 139, 154–55 (2013).

partnership has losses in excess of its gains, partners can use those losses to offset income from other sources.[258] If a religious or apostolic group, on the other hand, has losses in excess of its income, the losses will wipe out its taxable income, and members will receive no deemed dividend for the year. Members will not be able to use the excess loss to reduce their taxable income from other sources.

This theoretical disconnect between the taxation of partnerships, based on a conduit theory, and the taxation of religious and apostolic organizations, where the conduit theory is at best attenuated, reflects differences between partnerships and communitarian organizations. In general, individuals form partnerships—and invest assets or effort to become partners—to jointly carry on business.[259] Using a partnership to carry on business comes with a cost: partnership taxation has become tremendously complex.[260] Individuals who form partnerships believe that the benefits—including tax benefits—that come with the partnership form outweigh the cost and complexity.

Members of communitarian groups, by contrast, do not join for investment purposes, and, while members of communitarian groups pool their property to some extent,[261] they do not pool it in the same way as a traditional partnership. Rather, they join to participate in a community.[262] For individuals whose focus is community, not profit, subchapter K would require "excessive, often cost-prohibitive, expenditures."[263] Requiring unsophisticated communitarians to bear such prohibitive costs could impede their ability to create communitarian societies.[264]

Because partners form and invest in partnerships with the intention of earning a profit, they expect to receive some portion of their capital back upon dissociation (unless the partnership is

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[258] *Id.* at 154.

[259] UNIF. P'SHIP ACT § 202(a), 6 pt. I U.L.A. 92 (1997); *see also* Treas. Reg. § 301.7701-3(a) (2006) (providing that a "business entity" can be classified as a partnership for tax purposes).

[260] Andrea Monroe, *The New Revolution in Partnership Tax?*, 33 VA. TAX REV. 269, 272 (2013) ("The hallmark of subchapter K today is complexity.").

[261] This pooling can range from the Hutterites, who share virtually all of their property, to groups whose members maintain private finances but pool their assets for common expenses. MILLER, QUEST FOR UTOPIA, *supra* note 9, at xxi.

[262] *Id.* at xix (Communitarians "choose to live together and share at least some of their resources for the common good or for the betterment of the world").

[263] Monroe, *supra* note 260, at 272.

[264] Moreover, if communitarians wanted to use subchapter K, nothing prevents them from forming an entity, electing partnership taxation, and incurring the costs of compliance as they receive the benefits of true pass-through taxation.

insolvent).[265] Members of many religious and apostolic organizations, on the other hand, have no equity-like interest in the religious or apostolic organization, and have no expectation of receiving any distribution upon leaving or upon the termination of the group.[266]

Ultimately, the structure of religious and apostolic organizations differs too significantly from the structure of business entities taxed as partnerships to make subchapter K an apposite taxing regime for communitarian organizations. Congress deliberately decided that religious and apostolic organizations should not act as pure conduits for tax purposes. This conclusion makes practical sense, as the organization does not function primarily to aggregate individual investors' investments. Rather, communitarian organizations permit their members to share assets in a flexible manner.

C. *Tax-Exempt Churches*

Even if partnership taxation is unavailable to religious and apostolic organizations, section 501(d) could still be superfluous. If a communitarian religious organization could demonstrate that it was "organized and operated exclusively for religious . . . purposes,"[267] the organization would not only enjoy tax exemption itself, but its income would not pass through to members. As an additional benefit, members who donated their property to the organization could potentially deduct that donation.[268]

In fact, Meade Emory and Lawrence Zelenak argue that, as a result of the unrelated business income tax, section 501(d) has become largely superfluous.[269] The cases denying an exemption as a church to the Hutterites and the Israelite House of David occurred before the enactment of the unrelated business income tax.[270] These cases reflected a common unease with the idea of charitable organizations

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[265] *See* UNIF. P'SHIP ACT §§ 701(a), 807(a), 6 pt. I U.L.A. 175, 206 (1997).

[266] *See, e.g.*, van den Berghe & Peter, *supra* note 156, at 534 ("Defecting Hutterites leave with little more than their clothes."). *Cf.* Hackney, *supra* note 228, at 121 ("There are no 'owners' of a nonprofit organization; consequently, we cannot use a pass-through taxation system like we do for partnership where it is clear who owns the firm.").

[267] I.R.C. § 501(c)(3) (2015).

[268] *See id.* § 170(a) (2012). It is worth noting that, even if a member itemized her deductions, she may not be eligible to fully deduct her donations. She can only deduct charitable contributions of up to fifty percent of her adjusted gross income. *Id.* § 170(b)(1)(A).

[269] Emory & Zelenak, *supra* note 176, at 1110 ("In any event, section 501(d) may have lost most of its importance since the enactment of the unrelated business income tax.").

[270] *Id.*

earning money and, by implication, competing unfairly with for-profit businesses.[271] The courts found that the organizations' business operations "constituted a substantial non-exempt purpose."[272]

The unrelated business income tax, originally enacted in 1950,[273] taxes otherwise tax-exempt organizations on income they earn from carrying on a trade or business.[274] With the introduction of the unrelated business income tax, Emory and Zelenak argue, the I.R.S. recognized that the "operation of a trade or business is not a bar to exempt status."[275]

If the unrelated business income tax truly removed the bar from tax-exempt public charities' engaging in business, then it becomes necessary to explore whether section 501(d) provides benefits different from those provided by section 501(c)(3). If not, Congress could simplify the Code by eliminating section 501(d) and allowing qualifying religious and apostolic organizations to roll their exemptions over into section 501(c)(3). Put a different way, if religious and apostolic organizations could be exempt under section 501(c)(3), do they need section 501(d)?

Under current law, yes. True, the Code's requirement that public charities exempt under section 501(c)(3) be organized and operated *exclusively* for exempt purposes does not, in fact, prevent them from engaging in some amount of non-exempt business. The operational test instead interprets the "exclusivity" criterion as requiring an exempt public charity to engage *primarily* in activities that accomplish its exempt purpose or purposes.[276]

The Treasury regulations suggest, though, that religious and apostolic organizations would not meet even this less-strict operational test. The regulations do acknowledge explicitly that an organization may qualify for exemption under section 501(c)(3) even if it "operates a trade or business as a substantial part of its activities."[277] However, the trade or business must further the organization's exempt purposes, and its primary purpose cannot be to operate such a trade or business.[278] As the courts noted, the Hutterite groups carried on

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[271] *Id.* at 1109 n.155.

[272] *Id.* at 1109–10.

[273] Ethan G. Stone, *Adhering to the Old Line: Uncovering the History and Political Function of the Unrelated Business Income Tax*, 54 EMORY L.J. 1475, 1479 (2005).

[274] Brunson, *Tax Havens*, *supra* note 174, at 229–30.

[275] Emory & Zelenak, *supra* note 176, at 1110.

[276] Treas. Reg. § 1.501(c)(3)-1(b)(c)(1) (2014).

[277] *Id.* § 1.501(c)(3)-1(e)(1).

[278] *Id.*

significant business, with the purpose of supporting their members and purchasing property.[279] Equally damning, the regulations appear to specifically exclude religious and apostolic organizations from qualifying under section 501(c)(3):

> An organization which is organized and operated for the primary purpose of carrying on an unrelated trade or business is not exempt under section 501(c)(3) even though it has certain religious purposes, its property is held in common, and its profits do not inure to the benefit of individual members of the organization. See, however, section 501(d) . . . , relating to religious and apostolic organizations.[280]

Even without these explicit regulations, though, religious and apostolic groups could face significant impediments in attempting to claim an exemption under section 501(c)(3). The passage of the unrelated business income tax did not eliminate the operational test. The operational test requires public charities to engage primarily in activities that accomplish an exempt purpose.[281]

The operational test also includes a prohibition on private inurement.[282] In addition, a tax-exempt entity must act to further a public, not private, interest.[283] Under the prohibition of private inurement, no part of a tax-exempt entity's net earnings can inure to "the benefit of private shareholders or individuals."[284] The Treasury regulations define such private shareholders or individuals as those with a "personal and private interest in the activities of the organization."[285] In general, courts have found that a person has this personal and private interest "only if she can exert control over the charity's operations."[286]

The private inurement prohibition may, in some cases, cause

[279] Hutterite Bruder Gemeinde v. Comm'r, 1 B.T.A. 1208, 1211 (1925) ("There is no evidence that any of the funds of the taxpayer have ever been used to spread the doctrines of the Hutterische Bruder Gemeinde beyond the boundaries of the taxpayer's property or devoted to any service valuable to the general public."); Hofer v. United States, 64 Ct. Cl. 672, 684 (1928) ("[The net income] was for the benefit of its members.").

[280] Treas. Reg. § 1.501(c)(3)-1(b)(e)(1) (2014).

[281] *Id.* § 1.501(c)(3)-1(c)(1).

[282] *Id.* § 1.501(c)(3)-1(b)(c)(2).

[283] *Id.* § 1.501(c)(3)-1(d)(1)(ii) ("An organization is not organized or operated exclusively for one or more of the [exempt] purposes . . . unless it serves a public rather than a private interest.").

[284] *Id.* § 1.501(c)(3)-1(b)(c)(2).

[285] *Id.* § 1.501(a)-1(c).

[286] Johnny Rex Buckles, *The Federalization of the Duty of Loyalty Governing Charity Fiduciaries Under United States Tax Law*, 99 KY. L.J. 645, 660 (2011).

religious and apostolic groups to fail the operational test, depending on their governance. Presumably, those who run the common treasury are part of the community and share in the organization's income and assets in the same way as non-controlling members. To the extent they do, such religious or apostolic organizations would fail to qualify under section 501(c)(3); the private inurement prohibition has no safe harbor, even for de minimis amounts.[287] Theoretically, of course, a religious or apostolic organization that wanted to qualify under section 501(c)(3) could structure its governance in a way that did not implicate the private inurement prohibition, but turning over the management of communal assets to outsiders would presumably contravene its preferred method of allocating income to its membership and its preferred governance structure.

Even if a religious or apostolic group structured its governance and its allocations in a way that satisfied the operational test, however, it would likely violate the prohibition on excessive private benefit. Unlike the prohibition on private inurement, an exempt organization cannot be organized for the private benefit of *any* person or groups of people, not just those individuals who exercise control over the organization.[288] Still, the prohibition on private benefit does not entirely prohibit private benefit; rather, it only disqualifies an organization that provides more than incidental private benefit.[289]

The primary benefits of income from the communally-owned property flow to members of the organizations, and not to the general public.[290] Of course, providing benefits to a circumscribed group does not *always* cause an organization to fail the private benefit test.[291] To demonstrate that it does not provide an excessive public benefit, however, a religious or apostolic organization would need to demonstrate the "definiteness and charitable nature of the class to be benefited."[292] Members of a religious or apostolic group are unlikely

[287] *Id.* ("There is no de minimis safe harbor under the statute.").

[288] *Id.*

[289] *Id.* ("[T]he bestowal of an 'incidental' private benefit does not disqualify an organization from section 501(c)(3) under the private benefit doctrine.").

[290] *See* Hutterische Bruder Gemeinde v. Comm'r, 1 B.T.A. 1208, 1211 (1925) ("It is difficult to discover any benefit to the public flowing from the activities of this [communitarian religious group].").

[291] *See, e.g.*, Am. Campaign Acad. v. Comm'r, 92 T.C. 1053, 1075 (1989) ("[W]e have found that organizations which further exempt purposes through sponsoring legal or medical referral services did not confer private benefits so long as the referral service was open to a broad representation of professionals and no select group of professionals were the primary beneficiaries of the service.").

[292] Aid to Artisans, Inc. v. Comm'r, 71 T.C. 202, 215 (1978) (suggesting such demonstration can resolve whether an organization serves a private interest or its

to qualify as a charitable class. Even if they did, though, the tax law requires these benefits to flow to any member of the charitable class without selectivity toward the particular individuals who benefit.[293] Religious and apostolic organizations generally limit benefits to members of the organization and select recipients specifically according to their needs. As a result, a religious or apostolic organization is unlikely to qualify for a tax exemption under section 501(c)(3).[294]

Religious and apostolic organizations would not have an easier time meeting the requirements of section 501(c)(3) by virtue of being, or associating closely with, churches. Admittedly, Congress requires the I.R.S. to treat churches differently from non-church charities. The tax law differentiates non-church religious organizations from churches. Today, there are three principal differences between churches and non-church religious organizations for tax purposes. First, churches do not need to apply for a tax exemption and, in fact, are presumed to be public charities rather than private foundations.[295] Second, churches do not need to file returns with the I.R.S.[296] Finally, the I.R.S. faces significant restrictions on its ability to audit churches and on the church audits themselves.[297]

In spite of the special protections churches enjoy, however, they must still meet the requirements of section 501(c)(3), or they lose their tax exemption.[298] And even a church, to the extent it owned and operated businesses, the profit from which provided for its members' livelihoods, would risk failing to qualify under section 501(c)(3). Churches can, of course, provide financial support to the poor and needy. Such support falls comfortably within the ambit of section 501(c)(3)'s exempt purposes.[299] Yet providing financial support for the entire body of membership goes beyond merely providing for the poor and needy: it provides substantial benefits to members. These benefits—even if relatively modest—cause putative churches to fail the

"activities are conducted for private gain"), *acq. in result,* 1981-2 C.B.

[293] *Id.* at 215–16.

[294] *See* Treas. Reg. § 1.501(c)(3)-1(d)(1)(iii) (2014) (providing examples of putative tax-exempt organizations that serve a private, rather than public, benefit).

[295] I.R.C. § 508(a)-(c) (2012).

[296] *Id.* § 6033(a)(3)(A)(i) (2015).

[297] *Id.* § 7611 (1998).

[298] *See, e.g.*, Branch Ministries v. Rossotti, 211 F.3d 137, 139 (D.C. Cir. 2000) (upholding I.R.S.'s revocation of a "bona fide church's tax-exempt status because of its involvement in politics").

[299] Treas. Reg. § 1.501(c)(3)-1(d)(2) (2014) ("[Charity] includes: Relief of the poor and distressed or of the underprivileged . . . .").

private inurement test and the operations test.[300]

In addition, if a religious or apostolic organization wanted exemption under section 501(c)(3), it would have to meet the public policy requirement. While the I.R.S. currently applies the public policy requirement to religious and apostolic organizations,[301] it overreaches in doing so. Neither the tax law nor any tax policy requires communitarian organizations to meet the public policy requirement.[302] Although the I.R.S. overreaches in holding religious and apostolic organizations to the public policy requirement, the requirement clearly applies to organizations seeking an exemption under section 501(c)(3).[303]

The I.R.S. still polices whether tax-exempt organizations meet the public policy requirement. In 2013, the I.R.S. denied section 501(c)(3) tax-exempt status to Principle Voices of Polygamy, a putative educational and charitable organization formed to provide education about polygamous families and cultures, empower polygamous individuals and families, and provide crisis referrals to polygamists.[304] Using analysis similar to that used to deny section 501(d) status to the FLDS Church, the I.R.S. again stated that polygamy contravenes long-standing federal policy.[305] Since Principle Voices of Polygamy is "operated to condone and support those engaging in the illegal act of

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[300] *See* Canada v. Comm'r, 82 T.C. 973, 988 (1984) ("We do not doubt that one purpose for which the KLCC was operated was to permit members to explore various religions . . . . [However,] it is clear that, on the whole, the KLCC was operated, to more than an insubstantial degree, for nonexempt purposes and that it afforded its members benefits which violated the 'private inurement' test."); *see also* Ohnmeiss v. Comm'r, 62 T.C.M. (CCH) 1350 (1991) ("[T]he applicability of the 'private inurement' test did not turn upon the amount or extent of the benefits conferred but only on the question of whether there were benefits of any kind.").

[301] *See, e.g.*, I.R.S. Priv. Ltr. Rul. 2013-100-47 (Dec. 11, 2012) (denying exemption under section 501(d) to a polygamous group that otherwise qualifies for the exemption).

[302] *See supra* notes 108–110 and accompanying text.

[303] *See supra* notes 22–38 and accompanying text.

[304] I.R.S. Priv. Ltr. Rul. 2013-23-025 (Mar. 14, 2013). As with the FLDS Church private letter ruling, the I.R.S. was required to redact potentially identifying information in the private letter ruling. *See supra* note 87 and accompanying text. As with that private letter ruling, however, the I.R.S. carelessly failed to redact certain identifying information. The private letter ruling quotes the organization's website, including its message that it seeks "decriminalization of polygamy by . . . the removal or appropriate alteration of laws specifically targeting polygamists." *Id.* Although the Principle Voices of Polygamy website appears to have been taken down, a search for the quoted language attributes it to Principle Voices of Polygamy. *See Principle Voices*, APOLOGETICSINDEX (Sep. 17, 2008), http://www.apologeticsindex.org/137-principle-voices.

[305] I.R.S. Priv. Ltr. Rul. 2013-23-025 (Mar. 14, 2013).

polygamy [it] cannot be exempt under section 501(c)(3)."[306]

The I.R.S. is undoubtedly correct that polygamy violates federal public policy.[307] Supreme Court precedent is abundantly clear that the common law of charity excludes groups that violate public policy from the definition of "charitable."[308] Additionally, for an organization to qualify under section 501(c)(3), it must meet the common law definition of charitable.[309] If the FLDS Church *itself* owned the common property and claimed an exemption as a church, it would likely fail to qualify for exemption under section 501(c)(3), notwithstanding the lower threshold for qualification and the higher threshold for audit.[310] Even without the regulations denying the possibility of a religious or apostolic organization qualifying for section 501(c)(3) status,[311] churches face the same requirements—including the public policy requirement—as non-church public charities.[312] In fact, the I.R.S. is clear that it believes it has the authority and duty to revoke a church's tax-exempt status if that church acts in a way that violates public policy.[313]

VI. UPDATING SECTION 501(D)

Congress originally exempted religious and apostolic organizations from tax in 1936.[314] When it first enacted the predecessor to section 501(d), it probably did effectively exempt all of an apostolic or religious organization's income from taxation. Under the Revenue Act of 1936, individuals paid a normal tax of four percent

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[306] *Id.*

[307] Whether it should is an entirely different question. *See* Brunson, *Taxing Polygamy*, *supra* note 4, at 131.

[308] Bob Jones Univ. v. United States, 461 U.S. 574, 591 (1983) ("A corollary to the public benefit principle is the requirement, long recognized in the law of trusts, that the purpose of a charitable trust may not be illegal or violate established public policy.").

[309] *Id.* at 595–96 ("Whatever may be the rationale for such private schools' policies, and however sincere the rationale may be, racial discrimination in education is contrary to public policy. Racially discriminatory educational institutions cannot be viewed as conferring a public benefit within the 'charitable' concept discussed earlier, or within the congressional intent underlying . . . § 501(c)(3).").

[310] *See supra* notes 295–297 and accompanying text.

[311] *See supra* note 280 and accompanying text.

[312] *See supra* note 298 and accompanying text.

[313] Rev. Rul. 75-231, 1975-1 C.B. 158 (finding that church Z, which operates racially-discriminatory schools, fails to "qualif[y] as a charity for Federal income tax deduction and exemption purposes under section[] . . . 501(c)(3) of the Code").

[314] Revenue Act of 1936, ch. 690, § 101(18), 49 Stat. 1648, 1675–76; *see also* IRM 7.25.23.2 (Feb. 23, 1999) ("This provision dates back to the Revenue Act of 1936 . . . .").

of their net income.[315] In addition, the Revenue Act of 1936 imposed a graduated surtax, ranging from an additional four percent on income between $4,000 and $6,000 to seventy-five percent on income in excess of $5 million.[316]

Prior to World War II, though, the income tax was a class, rather than a mass, tax.[317] Although the four percent normal tax theoretically applied to a taxpayer's first dollar of income, the Revenue Act of 1936 provided a personal exemption of $1,000 for an individual, or $2,500 for a married couple, against both the normal tax and the surtax.[318] In addition, taxpayers received a $400 credit for each dependent.[319] According to the 1940 Census, the median family wage income in 1939 was $1,231.[320] Unless members of religious and apostolic organizations earned above-median wages, they likely did not pay the individual income taxes or surtaxes. Like most Americans, their income, instead, went untaxed.[321]

Today's federal income tax environment differs radically from the income tax of the pre-World War II world. The Code has grown significantly in scope and complexity.[322] Similarly, its reach has expanded dramatically: at no point during the 1930s did more than five percent of Americans pay federal income tax.[323] By 2010, more than ten times that percentage paid federal income taxes.[324] Likewise, in 1940, federal income tax receipts accounted for less than fourteen percent of federal revenue,[325] while in 2010, it accounted for forty-two

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[315] Revenue Act of 1936, ch. 690, § 11, 49 Stat. 1653.

[316] *Id.* § 12, 49 Stat. at 1653–55.

[317] JOSEPH J. THORNDIKE, THEIR FAIR SHARE: TAXING THE RICH IN THE AGE OF FDR 231 (2013) ("The broad-based, individual income tax was the defining characteristic of the World War II tax regime.").

[318] Revenue Act of 1936, ch. 690, § 25(b)(1), 49 Stat. 1663.

[319] *Id.* § 25(b)(2), 49 Stat. at 1663.

[320] Sara LaLumia, *The Effects of Joint Taxation of Married Couples on Labor Supply and Non-Wage Income*, 92 J. PUB. ECON. 1698, 1703 (2008).

[321] Carolyn C. Jones, *Class Tax to Mass Tax: The Role of Propaganda in the Expansion of the Income Tax During World War II*, 37 BUFF. L. REV. 685, 685 (1988/89) ("During the 1930s, no more than five percent of Americans were income taxpayers.").

[322] *See, e.g.*, Sheldon D. Pollack, *Tax Complexity, Reform, and the Illusions of Tax Simplification*, 2 GEO. MASON INDEP. L. REV. 319, 319–20 (1994) ("In the post-[World War II] era, especially during the 1970s and 1980s, the level of complexity of the income tax increased dramatically.").

[323] Jones, *supra* note 321, at 685 ("During the 1930s, no more than five percent of Americans were income taxpayers.").

[324] Michael M. Gleeson, *Larger Percentage of Americans to Pay Income Taxes in 2014*, 140 TAX NOTES 987, 987 (2013) (stating that in 2010, approximately fifty-two percent of Americans paid the federal income tax).

[325] STEVEN A. BANK ET AL., WAR AND TAXES 95 (2008) ("Between 1940 and 1956 . . . [the federal income tax's] yield soar[ed] from $13.6 billion to $40.7 billion.").

percent of federal revenue.[326]

In spite of the radical changes to the nature of the federal income tax between the pre-World War II era and today, the current version of section 501(d) is nearly identical to what Congress enacted originally in 1936.[327] Even though Congress has not tinkered with section 501(d), it mostly functions well in its current form, reflecting the unique economics of communitarian organizations. That said, there are certain changes that, in addition to correcting its ambiguities and the I.R.S.'s misapplication of the public policy doctrine, would improve section 501(d). Expanding the availability of section 501(d) would also provide Congress a convenient opportunity to update and improve the provision in light of the massive structural changes to the overall tax law that have occurred between its original enactment and today.

A. *Religious or Apostolic (or Not)*

Religious individuals are not the only Americans who have pursued communal living. Non-religious communitarian groups have a long history in the United States,[328] and even today, certain groups of people look at communitarian living as an attractive alternative to standard contemporary American life.[329] Although Congress appears

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[326] Andrea Louise Campbell, *America the Undertaxed: U.S. Fiscal Policy in Perspective*, 91 FOREIGN AFF. 99, 103 (Sept.–Oct. 2012).

[327] Comparing the language of the provision as originally enacted and as it exists today shows that the only change, besides an introductory phrase that has been added, is the amendment of "net income" in the original version to "taxable income" today. A blackline comparison between the language of section 101(18) of the Revenue Act of 1936 and I.R.C. § 501(d) (with additions marked by underlining and deletions by strike-through) looks like this:

> The following organizations are referred to in subsection (a): Religious or apostolic associations or corporations, if such associations or corporations have a common treasury or community treasury, even if such associations or corporations engage in business for the common benefit of the members, but only if the members thereof include (at the time of filing their returns) in their gross income their entire pro-_rata shares, whether distributed or not, of the ~~net~~taxable income of the association or corporation for such year. Any amount so included in the gross income of a member shall be treated as a dividend received.

[328] In 1844, Brook Farm embraced Fourierism, a non-religious communalist movement. *See* Carl J. Guarneri, *Brook Farm and the Fourieriest Phalanxes: Immediatism, Gradualism, and American Utopian Socialism*, *in* AMERICA'S COMMUNAL UTOPIAS 159, 161–63 (Donald E. Pitzer ed., 1997). The late nineteenth century saw the rise of communitarian single-tax enclaves. MILLER, QUEST FOR UTOPIA, *supra* note 9, at 31. By the 1960s and 1970s, secular communes exploded with the rise of the hippies. *Id.* at 198.

[329] *See, e.g.*, *supra* notes 141–144 and accompanying text.

to have designed section 501(d) specifically with high-visibility religious communitarian groups in mind,[330] there was no compelling reason to limit its availability solely to such groups.

Not only is there no compelling reason to limit section 501(d) to religious communitarian groups, but the current structure of section 501(d) may violate the Establishment Clause of the Constitution.[331] While tax policy, standing on its own, justifies the expansion of the section 501(d) exemption to secular communitarian organizations, the Establishment Clause may demand such an expansion. Although analyzing section 501(d) in light of the Establishment Clause goes beyond the scope of this Article, it is worth briefly laying out why section 501(d) likely violates the Constitution.

Though the Supreme Court's Establishment Clause jurisprudence is, at best, incoherent,[332] the Court has consistently held that the Constitution permits tax provisions that benefit religion.[333] At the same time, though, those tax benefits must serve a secular purpose and must be available broadly, not just to religious groups, but to non-sectarian ones, too.[334]

As currently constituted, section 501(d) violates this test. It is available only to "religious or apostolic associations or corporations."[335] Although the Code does not explicitly define "religious or apostolic," such terms cannot reasonably be read as including secular organizations.[336]

Congress could easily deal with any potential Establishment

[330] *See supra* notes 190–193 and accompanying text.

[331] U.S. CONST. amend. I ("Congress shall make no law respecting an establishment of religion . . . .").

[332] *See* PAUL HORWITZ, THE AGNOSTIC AGE: LAW RELIGION, AND THE CONSTITUTION xxvii (2011) ("[T]he central doctrinal approaches to the Free Exercise and Establishment Clauses of the First Amendment . . . whatever their practical merits, are intellectually inconsistent and ultimately incoherent.").

[333] *See* Walz v. Tax Comm'n, 397 U.S. 664, 680 (1970) ("It appears that at least up to 1885 this Court, reflecting more than a century of our history and uninterrupted practice, accepted without discussion the proposition that federal or state grants of tax exemption to churches were not a violation of the Religion Clauses of the First Amendment. As to the New York statute, we now confirm that view.").

[334] Texas Monthly, Inc. v. Bullock, 489 U.S. 1, 14–15 (1989) ("Insofar as that subsidy is conferred upon a wide array of nonsectarian groups as well as religious organizations in pursuit of some legitimate secular end, the fact that religious groups benefit incidentally does not deprive the subsidy of the secular purpose and primary effect mandated by the Establishment Clause.").

[335] I.R.C. § 501(d) (2015).

[336] *Cf.* Freedom from Religion Found., Inc. v. Lew, 983 F. Supp. 2d 1051, 1071 (W.D. Wisc. 2013) ("In this case, no reasonable construction of § 107 would include atheists."), *vacated*, 773 F.3d 815 (7th Cir. 2014).

Clause issue in one of two ways. On the one hand, it could repeal section 501(d). Without section 501(d), however, no tax regime would accurately reflect the economics of communitarian organizations, whether religious or not.[337] As such, entirely eliminating section 501(d), while solving the Establishment Clause problem, is not a good solution from a tax perspective.

Expanding section 501(d) to include any qualifying communitarian organization, irrespective of ideology, would also eliminate any potential Establishment Clause problems. Admittedly it would continue to provide a tax benefit to religious groups, but the Establishment Clause does not prevent religious groups from enjoying beneficial tax treatment.[338] Rather, violation occurs when such benefits are available *exclusively* to religious organizations.[339] Expanding the availability of section 501(d) beyond religious organizations, then, would allow section 501(d) to pass constitutional muster.

Tax policy considerations also militate in favor of expanding the exemption to include non-religious communitarian organizations. Horizontal equity (the idea that similarly-situated taxpayers should face similar tax burdens)[340] clearly supports treating religious and non-religious communitarian groups the same way for tax purposes. As a nearly universal matter, tax policymakers view horizontal equity as an important goal in designing tax regimes.[341]

Although widespread, the use of horizontal equity in determining how to impose taxes is also controversial. One school of tax policy theorists argues that horizontal equity has no theoretical justification or foundation as a stand-alone norm.[342] Another disputes the dismissal of horizontal equity, arguing that it has something important to say in the design of a tax regime.[343] Answering the question of whether

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[337] *See supra* Part V.

[338] *Texas Monthly, Inc.*, 489 U.S. at 14–15.

[339] *Id.* at 14.

[340] *See* Brunson, *Taxing Polygamy*, *supra* note 4, at 124 ("[T]he tax norm of horizontal equity . . . holds that taxpayers with similar income should pay a similar amount of taxes.").

[341] *See, e.g.*, David Elkins, *Horizontal Equity as a Principle of Tax Theory*, 24 YALE L. & POL'Y REV. 43, 43 (2006) ("[Horizontal equity] is universally accepted as one of the more significant criteria of a 'good tax.'").

[342] *See, e.g.*, *id.* at 89 ("If, on the other hand, horizontal equity is a goal to strive for—a claim which has yet to be proven—then its normative grounding would be in direct conflict with that of vertical equity."); Louis Kaplow, *A Note on Horizontal Equity*, 1 FLA. TAX REV. 191, 191 (1992) ("The gap in the literature [seeking to justify the horizontal equity norm] remains . . . .").

[343] *See, e.g.*, Richard A. Musgrave, *Horizontal Equity, Once More*, 43 NAT'L TAX J. 113, 114 (1990) ("The independent role of [horizontal equity] becomes apparent once

horizontal equity should underlie decisions of how to tax individuals and entities is beyond the scope of this Article. It is also unnecessary to my conclusions that Congress should make section 501(d) exemption available to non-religious communitarian organizations. Even if commentators could definitively demonstrate that horizontal equity had no place in the design of tax regimes, a tax regime should treat identically-situated taxpayers identically.[344]

In determining whether two taxpayers are identical, Professor David Elkins argues that differences in "income, consumption patterns, marital status or place of residence" break the necessary identity between two taxpayers.[345] Some differences, however, must be irrelevant for tax purposes. If not, the idea of identical taxpayers becomes meaningless. Presumably, for example, differences in gender or race should not produce differences in tax liability, because such differences have no relation to a person's ability or duty to pay taxes.[346]

Similarly, there is no tax-relevant difference between a religious communitarian group where the members contribute all of their assets to a common treasury and receive support from that treasury, and a non-religious communitarian group where members contribute to and receive from an identical common treasury. The religious/secular divide does not change the economics of the communities, nor does it create any cognizable difference for tax purposes.

Notwithstanding the potential for identical religious and non-religious communitarian organizations, they will almost certainly differ, whether in size, in organizational structure, or in the type of business in which they engage. Even if we accept that horizontal equity should not be treated as a stand-alone tax norm, however, these potential differences do not counter the conclusion that a section 501(d) election should be available to qualifying non-religious communitarian groups. Section 501(d) already applies broadly:

focus on an optimal outcome is replaced by comparison of second-best solutions.").

[344] Elkins, *supra* note 341, at 44 ("Tautologically, any conceivable tax arrangement will treat identically situated taxpayers equally.").

[345] *Id.*

[346] That such differences should not have tax relevance does not mean, however, that they do not. Professor Dorothy Brown, for example, has demonstrated that the benefits and burdens of taxes are distributed differently depending on race and gender. *See, e.g.*, Dorothy A. Brown, *Shades of the American Dream*, 87 WASH. U. L. REV. 329, 332 (2009) ("Government subsidies for homeownership, especially federal tax subsidies, create winners and losers generally along race and class lines."); Dorothy A. Brown, *Race, Class, and Gender Essentialism in Tax Literature: The Joint Return*, 54 WASH. & LEE L. REV. 1469, 1512 (1997) ("[T]his Article shows how the gender bias literature's focus on wives as secondary wage earners ignores how federal tax laws benefit upper-income white families and penalize African-American families . . . .").

religious communitarian groups' structures and economics vary, and yet these differing economics all fit within the ambit of section 501(d) as long as they have a common treasury. The differences between religious incentives to enter a communitarian organization and other incentives should not matter for tax purposes.

Eliminating the "religious or apostolic" requirement would provide benefits beyond meeting the policy requirements of horizontal equity, though. By expanding the availability of section 501(d) to non-religious communitarian organizations, Congress would eliminate any potential violation of the Establishment Clause.[347]

Eliminating the "religious or apostolic" requirement would also significantly reduce the uncertainty and ambiguity surrounding which groups qualify under section 501(d).[348] Uncertainty imposes real and significant costs on taxpayers and on the public.[349] Although section 501(d) and its predecessors have only been available to *religious* or *apostolic* organizations since the provision's inception in 1936,[350] neither Congress nor the Treasury Department has seen fit to define the terms.[351] If Congress makes section 501(d) available to non-religious communitarian organizations, it will never need to make such a definition and will eliminate a significant source of uncertainty for communitarian organizations.

B. *Reducing Ambiguity*

Although section 501(d) functions well enough, after more than three-quarters of a century, there are other details that merit examination and possible change. These changes will not only improve the effectiveness of the statutory scheme applicable to communitarian groups, but they may also reduce the incentives to use exempt communitarian groups as vehicles for tax avoidance.

As discussed above, by eliminating the requirement that an entity qualify as "religious or apostolic" for exemption under section 501(d), Congress would significantly diminish the ambiguity and uncertainty in the provision.[352] It would also eliminate this uncertainty without needing to draft a definition. "Religious or apostolic" is not, however,

[347] *See supra* notes 338–339 and accompanying text.

[348] *See supra* notes 200–203 and accompanying text.

[349] Leandra Lederman & Ted Sichelman, *Enforcement as Substance in Tax Compliance*, 70 WASH. & LEE L. REV. 1679, 1732–33 (2013).

[350] *See* Revenue Act of 1936, ch. 690, §101(18), 49 Stat. 1648, 1675.

[351] *See* I.R.C. § 501(d) (2015) (includes no definition of *religious* or *apostolic*); Treas. Reg. § 1.501(d)-1 (1960) (includes no definition of *religious* or *apostolic*); s*ee also* Twin Oaks Cmty., Inc. v. Comm'r, 87 T.C. 1233, 1244 (1986), *acq.*, 1987-2 C.B. 1.

[352] *See supra* Part VI.A.

the only source of uncertainty and ambiguity in section 501(d). A qualifying organization must also have a "common treasury or community treasury."[353] Neither Congress nor the Treasury Department has deigned to define those terms, however.[354]

Unlike "religious or apostolic," Congress cannot—and should not—write "common or community treasury" out of the Code. The idea of a common treasury, used to provide for members of the communitarian organization, is the principal reason for section 501(d). If these organizations operated like normal corporations or normal partnerships, distributing or allocating their income pro rata according to equity-holders' interests, section 501(d) would be unnecessary. At the same time, though, eliminating 501(d) would flatten the range of economic structures available to communitarian groups, impoverishing economic experimentation.

To reduce the uncertainty created by the treasury requirement, Congress must define what it means by "common treasury or community treasury."[355] Though the current Congress has no access to the original legislative intent in passing the predecessor to section 501(d), it can use its experience over the lifetime of the exemption to draft a definition that would work for communitarian groups today. The Tax Court provided a sensible starting point for that definition, holding that

> an organization has a "common treasury" or "community treasury," as used in section 501(d), when all of the income generated internally by community-operated businesses and any income generated from property owned by the organization is placed into a common fund that is maintained by such organization and is used for the maintenance and support of its members, with all members having equal, undivided interests in this common fund, but no right to claim title to any part thereof.[356]

Although the Tax Court's definition provides a good starting

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[353] I.R.C. § 501(d) (2015).

[354] *Twin Oaks Cmty., Inc.*, 87 T.C. at 1243 ("Unfortunately, these terms are not defined in the Code or in the regulations.").

[355] Alternatively, to the extent it does not want to or cannot define the terms, it could instruct the Treasury Department to define them. I.R.C. § 7805(a) (2012) ("[T]he Secretary [of the Treasury] shall prescribe all needful rules and regulations for the enforcement of this title . . . ."). Congress can explicitly instruct the Treasury Department to issue this type of legislative regulation. *See, e.g.*, *id.* § 475(g) (2002) ("The Secretary shall prescribe such regulations as may be necessary or appropriate to carry out the purposes of this section . . . .").

[356] *Twin Oaks Cmty., Inc.*, 87 T.C. at 1254.

point, Congress should nonetheless use caution before adopting it wholesale. In defining a common or community treasury, Congress should clarify that a qualifying communitarian organization need not allocate or distribute its income evenly among members. Such groups should have the flexibility, if they so desire, to allocate assets to their members according to some definition of need, rather than being required to allocate evenly or according to some sense of dessert.[357]

To ensure that qualifying communitarian organizations maintain this flexibility, the definition of common or community treasury should clarify that a qualifying communitarian organization cannot maintain anything akin to a capital account. Allocations and distributions to members must have no relation to the amount that the members contributed to the communitarian group, whether upon joining or subsequently. The tax law should allow communitarian organizations to remain flexible in their approach to allocations and distributions, not requiring, for example, that they only take into account need. But an organization that merely wants to allocate income according to investment already has a tax-advantaged vehicle available: such taxpayers can and should use subchapter K instead.

Finally, the definition of common or community treasury must make clear that members have no ongoing ownership interest in their contributions.[358] This becomes important when members leave, or when the communitarian organization dissolves. Though some communitarian organizations do not distribute anything to departing members,[359] the tax law should not mandate non-distribution. No tax policy justification exists for preventing communitarian organizations from distributing assets to departing members if they desire to do so. Distributions to departing members and distributions in liquidation of the communitarian organization must, however, be treated by departing members as dividends, taxable at the members' ordinary rates.[360]

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[357] It is possible that the Tax Court's definition is broad enough to incorporate communitarian groups that allocate other than strictly pro rata or pro rata according to some sense of merit. But it would be worth explicitly stating that this is the case.

[358] Prohibiting capital accounts may sufficiently demonstrate this lack of ongoing ownership.

[359] *See supra* note 266 and accompanying text.

[360] Treating distributions to departing members in distributions in liquidation of communitarian organizations as dividends potentially parts ways with ordinary corporate taxation. A corporation can only pay dividends to the extent of its earnings and profits. I.R.C. § 316(a) (2012). To the extent that a distribution exceeds a corporation's earnings and profits, a shareholder treats the excess as a return of capital to the extent of her basis in the shares, and as capital gain to the extent it exceeds her basis. *Id.* § 301(c)(2)–(3) (2012). Under section 501(d), though, distributions are not

Treating liquidating distributions as ordinary income differs from the tax consequences of dissociation in other entity tax regimes. Under the corporate income tax, for example, qualifying corporate distributions in redemption of a shareholder's stock can be treated as payment in exchange for that stock.[361] As a result, redeeming shareholders can qualify for advantageous capital gains rates on the amount they receive in excess of their basis.[362] Because members of communitarian organizations do not have ownership interests in the organization or capital accounts, however, the idea of distributions constituting capital gain or return of capital is meaningless. The Code should clarify that such distributions constitute dividends, however, to ensure that members of communitarian organizations do not try to treat liquidating distributions as tax-free or subject to preferential tax rates.

C. *Utopian Groups Are Poor Vehicles for Tax Evasion*

Congress would undoubtedly prefer that the broader availability of section 501(d) did not materially diminish federal revenue.[363] One argument against the expansion of section 501(d) would be the risk that such expansion would encourage taxpayers to form communitarian organizations rather than standard C corporations to avoid the second layer of taxation. To the extent that people favored these communitarian organizations, fewer taxable corporations would exist, which, in turn, could erode the corporate tax base.[364] If, in fact,

actually dividends; they are only "treated as a dividend received." *Id.* § 501(d) (2015). Because members of these communitarian organizations are not shareholders in the entity, their taxable income should not be constrained by the organization's earnings and profits. In the taxation of communitarian organizations, any liquidating distribution should be taxable to the departing member as if it were a dividend.

[361] *Id.* § 302(a) (2010).

[362] *See, e.g.*, I.R.C. § 301(c)(2)–(3) (2012); Metzger Trust v. Comm'r, 76 T.C. 42, 49 (1981) ("Section 302(a) treats such [redemption] distributions as 'payment in exchange for the stock,' taxable as capital gain."), *aff'd,* 693 F.2d 459 (5th Cir. 1982).

[363] If it did significantly reduce federal revenue, the federal government would have to raise taxes, either generally or on another group of taxpayers, to make up for the lost revenue, essentially causing other taxpayers to subsidize utopian groups. While such intra-taxpayer subsidies are permissible, there does not appear to be a compelling reason for subsidy in this case.

[364] Similar concerns about widespread use of master-limited partnership sparked the enactment of the publicly traded partnership rules. *See, e.g.*, Susan Pace Hamill, *The Taxation of Domestic Limited Liability Companies and Limited Partnerships: A Case for Eliminating the Partnership Classification Regulations*, 73 WASH. U. L. Q. 565, 577 (1995) ("[I]n 1987 Congress added section 7704 to the Code, which conclusively treats publicly traded partnerships as corporations for tax purposes. This legislative determination of corporate status was based on the assumption that publicly traded partnerships eroded the corporate tax base.") (internal footnotes omitted).

it would do so, that may be sufficient reason not to expand the availability of section 501(d).[365]

However, people are unlikely to use communitarian organizations in a manner that would erode the corporate tax base. Given that members of communitarian organizations exempt under section 501(d) must pay taxes on their share of the organization's income, whether or not the organization distributes its income,[366] these organizations offer no way for individuals to defer their taxes. With ordinary corporations, on the other hand, while the corporation pays taxes on its income, shareholders do not owe taxes until the corporation distributes its income to them.[367] Under current law, when shareholders receive dividends from most U.S. and some foreign corporations, they pay taxes at preferential long-term capital gain rates.[368] Members of communitarian organizations exempt under section 501(d), however, do not get the benefit of the preferential rate on dividends.[369] Rather, they pay taxes on both actual and deemed dividends at their marginal tax rate. While that marginal rate may be low for members of utopian communitarian organizations,[370] people considering forming a communitarian group for tax-evasive purposes would likely pay taxes at higher marginal rates. Such higher-income individuals have more incentive to structure their affairs to avoid taxes than do low-income individuals.[371]

While section 501(d) provides that communitarian organizations and their members pay less collectively in taxes than if the organization were subject to the corporate income tax, exempting communitarian organizations from entity-level taxation does not meaningfully erode the tax base. Religious and apostolic organizations exist primarily as a legal form to hold the communal property. Without that legal form, communitarian groups could instead have members contribute the property to an individual or have them continue to hold title to the

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[365] *Cf.* Victor Fleischer, *Taxing Blackstone*, 61 TAX L. REV. 89, 114 (2008) ("While certainly not a crime, there is something to be said for responding swiftly to new structures that erode the corporate tax base.").

[366] I.R.C. § 501(d) (2015).

[367] *Id.* § 301(c)(1) (2012).

[368] *Id.* § 1(h)(11) (2012).

[369] *Id.* § 1(h)(11)(B)(ii)(I).

[370] *See, e.g.*, MILLER, THE 60S COMMUNES, *supra* note 134, at 34 ("By the prevailing standards of a relentlessly acquisitive society, Drop City was always an economic disaster area . . . . To visitors, the place often seemed engulfed in poverty . . . .").

[371] *Cf.* Andrew Johns & Joel Slemrod, *The Distribution of Income Tax Noncompliance*, 63 NAT'L TAX J. 397, 412 (2010) ("[W]hen taxpayers are arrayed by their estimated 'true' income, the ratio of aggregate misreported income to true income generally increases with income.").

property personally. In either event, the tax law would not impose a second layer of taxation. Either alternative form of ownership, while preferable to facing double taxation, represents a distortion in the members' economic preferences. These alternatives may also provide worse non-tax outcomes for members. If an individual owned all of the property personally, for example, the members would have no substantial protection from that individual's misuse of the property for her private benefit.

D. *Preventing Utopian Tax Evasion*

This is not to say, of course, that exempting utopian groups from entity-level taxation provides *no* opportunities for tax evasion. There are two broad avenues that members of religious and apostolic organizations could use to exploit the exemption and illegitimately reduce their taxes. The first is in the exchange of appreciated assets. If an individual transfers an appreciated asset in exchange for other assets, she must pay taxes on the unrealized appreciation.[372] If, however, she contributes it to a communitarian organization, she recognizes no gain or loss on the property.[373] The communitarian organization could then distribute it to another member of the group, ideally also tax-free.

In fact, this type of transaction—called a "mixing bowl" transaction—can occur under subchapter K.[374] Partners do not recognize gain on the contribution of appreciated property to a partnership.[375] Likewise, neither a partnership nor its partners recognizes gain when the partnership distributes appreciated property.[376] To combat these mixing bowl transactions, Congress enacted "a highly complex set of rules that distinguishes between partnership transactions and mixing bowl sales, with safe harbor periods, presumptions, exceptions, required risk allocations, allowable preferred returns, accommodation partner rules, and dozens of examples."[377]

Under the expanded definition of "common or community

[372] Treas. Reg. § 1.1001-1(a) (2015) ("[T]he gain or loss realized . . . from the exchange of property for other property differing materially either in kind or in extent, is treated as income or as loss sustained.").

[373] *See, e.g.*, Campbell v. Prothro, 209 F.2d 331, 336 (5th Cir. 1954) (holding that gifting appreciated property does not constitute a realization event).

[374] David A. Weisbach, *Formalism in the Tax Law*, 66 U. CHI. L. REV. 860, 863 (1999).

[375] I.R.C. § 721(a) (2012).

[376] *Id.* § 731(a) (1997).

[377] *See* I.R.C. §§ 704(c)(1)(B) (2004), 707(a)(2)(B) (1986), 737 (2012); Weisbach, *supra* note 374, at 864.

treasury" I propose,[378] however, religious and apostolic organizations would not need complex rules to police this type of tax evasion. While contributing an appreciated asset to a communitarian organization would still not constitute a realization event, any distribution to another member would be taxable to that member. So, while the donor could avoid paying tax, the recipient would pay tax on its full value (at ordinary rates), significantly reducing taxpayers' incentives to abuse the communitarian form.

The second type of tax evasion exempt communitarian organizations could facilitate is evasion of payroll taxes. The allocations members receive from the communal organization are treated as dividends for tax purposes. The I.R.S. has held that although members of religious or apostolic groups must include these deemed dividends in their gross income for federal income tax purposes, they do not need to include the deemed dividends in calculating their self-employment tax.[379] Nor does the communitarian organization need to withhold payroll taxes.[380] The ability to avoid these payroll and self-employment taxes represents real savings: under current law, these payroll taxes total 15.3 percent of an employee's wages, with half paid by the employee and half by the employer.[381] Self-employed individuals are liable for the full 15.3 percent (of self-employment, rather than wage, income) themselves.[382]

To the extent an individual can transform her wage or self-employment income into dividend income, then, she can significantly reduce her overall tax liability. And to the extent she can control the allocations of a communitarian group, the structure of section 501(d) would allow her to do so. At least some religious and apostolic groups use their allocations to replace paying wage income to their members,

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[378] *See supra* notes 358–362 and accompanying text.

[379] Rev. Rul. 58-328, 1958-1 C.B. 327.

[380] *See* Stahl v. United States, 626 F.3d 520, 526 (9th Cir. 2010) ("SHB [a religious or apostolic organization] does provide for all of the members' personal needs, including food, clothing, housing, medical care, and education, but it does not treat those as wages (it does not pay payroll taxes for them).").

[381] Because of various ceilings and floors, certain taxpayers may owe more or less than 15.3 percent. Broadly speaking, the employee's share of Social Security taxes is 6.2 percent of her wages, with an additional Medicare tax of 1.45 percent of those wages. I.R.C. § 3010(a), (b) (2012). Her employer owes an excise tax of an additional 6.2 percent and 1.45 percent of her wages, respectively. *Id.* § 3111(a)–(b) (2015). The Social Security portion of the payroll taxes is capped, see *id.* § 3121(a)(1) (2014), but the Medicare tax is uncapped and, in fact, is increased by 0.9 percentage points on income above a certain amount. *Id.* § 3101(b)(2) (2014).

[382] *Id.* § 1401(a)–(b) (2014).

in spite of the members' working for organization-owned businesses.[383]

Any controlled pass-through entity risks transforming compensation for services into passive income, not subject to payroll taxes. This risk is not purely theoretical. In *David E. Watson, P.C. v. United States*, for example, an accountant formed a wholly-owned S corporation, which held his interest in the accounting firm he worked for.[384] The S corporation paid him $24,000 a year for the two years at issue, and distributed the rest of his share of the firm's income—$203,651 and $175,470, respectively—as dividends.[385] For non-tax purposes—and, for that matter, for *income tax* purposes—whether he received the income as salary or dividends made no difference. But by shifting his income from wage income to dividend income, the accountant saved thousands of dollars in payroll taxes.[386] Similarly, some argue that private investment fund managers use carried interest to convert compensation for services into passive income.[387] This passive income is taxed at preferential rates, but it is also free from payroll taxes.[388] By using pass-through entities to transform their active income into passive income, taxpayers can significantly reduce their net taxes.

Even if Congress declines to expand the availability of section 501(d) to non-religious communitarian organizations, it should provide the I.R.S. with explicit authority to prevent taxpayers from exploiting this loophole in the tax law. Expanding the availability of section 501(d) would put more pressure on government revenues as more people could structure their affairs such that they were both members and employees of a communitarian group. As employees, they could minimize their wage income, thus minimizing their payroll taxes. As members, though, they could make up the lost wages

383 *See Stahl*, 626 F.3d at 526 ("[I]t cannot be doubted that SHB does not withhold taxes, including Social Security taxes, or withhold workers' compensation or unemployment insurance.").

384 Watson v. United States, 668 F.3d 1008, 1012 (8th Cir. 2012).

385 *Id.* at 1012–13.

386 *Id.* at 1013 (tax court imposed $23,431.23 of taxes, interest, and penalties). This tax shelter is commonly known as the "John Edwards Shelter." Emily Ann Satterthwaite, *Entry-Level Entrepreneurs and the Choice-of-Entity Challenge*, 10 PITT. TAX REV. 139, 143 n.3 (2013).

387 *See* Samuel D. Brunson, *Taxing Investment Fund Managers Using a Simplified Mark-to-Market Approach*, 45 WAKE FOREST L. REV. 79, 101 (2010) ("[T]he debate [over carried interest] has so far focused on whether carried interest is a return to capital or to labor . . . .").

388 Willard B. Taylor, *Payroll Taxes—Why Should We Care? What Should Be Done?*, 137 TAX NOTES 983, 994 (2012) ("[A] consequence of treating [carried interest] as ordinary would make it subject to the tax on self-employment income.") (footnote omitted).

through increasing their allocations. While they would pay income taxes on the full amount at their marginal tax rates, they would not pay payroll taxes.

Still, the dollar amounts at issue with this loophole are likely small, given both that communitarian organizations generally do not provide their members with significant amounts of income and given that relatively few communitarian organizations exist in the United States. Instead of further complicating section 501(d), the simplest way to prevent members of exempt communitarian organizations from exploiting this payroll tax (and other unforeseen types of tax evasion) would be to include an anti-abuse provision in the Code or in the Treasury regulations.[389] That provision could provide the I.R.S. with the authority to recast a communitarian organization's transactions if its transactions violated the purposes underlying section 501(d).[390]

VII. CONCLUSION

Because the tax law applies broadly to all U.S. taxpayers, it must calibrate its default assumptions to the economics facing most Americans. For certain individuals and groups, though, such assumptions create bad results. In those cases, it may be worth risking some additional complexity to accommodate the different economics.

Congress has demonstrated, in enacting section 501(d), that it is capable of navigating this terrain. Section 501(d) does an excellent job of reflecting the economics of many communal organizations, but, in its current form, it also leaves many stuck in the rules designed for participants in the United States' default capitalism. Among other

[389] Anti-abuse rules are, in some ways, more problematic than bright-line rules. For example, because of the vagueness inherent in an anti-abuse rule, they raise the costs of tax compliance. Sheldon I. Banoff, *The Use and Misuse of Anti-Abuse Rules*, 48 TAX LAW. 827, 835–36 (1995). As an alternative, Congress could require communitarian organizations to pay member-employees an arm's-length salary. Such a bright-line rule is complicated to administer, though. The transfer pricing rules, for example, require transactions between related parties to have arm's-length pricing. Treas. Reg. § 1.482-1(b)(1) (2015). The regulations to implement those arm's-length prices currently comprise 191 pages in the Code of Federal Regulations. *See* 26 C.F.R. §§ 1.482-0–1.482-9 (2016). Compared with that level of complexity, the vagueness of an anti-abuse rule would likely impose less of an administrative burden on taxpayers than a bright-line rule.

[390] This type of anti-abuse rule could be modeled after the subchapter K anti-abuse rule. That rule, found in the Treasury regulations, first lays out the intent underlying subchapter K. Treas. Reg. § 1.701-2(a) (1995). It then provides that, if a partnership is used in a way that violates that intent, the Commissioner has authority to "recast the transaction for federal tax purposes, as appropriate to achieve tax results that are consistent with the intent of subchapter K, in light of the applicable statutory and regulatory provisions and the pertinent facts and circumstances." *Id.* § 1.701-2(b).

things, it is available only to religious communitarian groups, its central qualification standards remain ambiguous at best, and the I.R.S. impedes even legitimate communitarian groups from using the regime by importing inapposite and unsupportable requirements into the regime.

These impediments are entirely unnecessary, and should be eliminated. If it does nothing else, Congress must clarify that religious and apostolic organizations are quasi-pass-through entities, not tax-exempt entities. The easiest way to accomplish this clarification would be to remove the tax regime applicable to communitarian organizations from section 501, which broadly governs tax-exempt organizations. Without that immediate association, the I.R.S. will be better able to understand what the regime does, economically.

But Congress should not stop with clarifying the nature of the tax regime. It should also expand the availability of section 501(d) to any communitarian organization that has a common treasury and where members will include their share of the organization's income in their gross income.

Finally, in addition to expanding the availability of section 501(d), Congress needs to clarify the qualification requirements for the exemption. Substantially unchanged after three-quarters of a century, some of the requirements remain ambiguous. Other requirements imposed by the I.R.S. are unnecessary. In any event, by clarifying the Code and reining in the I.R.S., Congress will lower the cost of entry into communitarian life without risking any significant erosion of the corporate tax base and without significantly diminishing its revenue.