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Internal Revenue Manual

Handbook 7.8.2 Exempt Organizations Technical Guidelines Handbook

Chapter 27 Religious and Apostolic Associations

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[7.8.2] 27.1 (02-23-1999) Requirements for Exemption

1. IRC 501(d) provides exemption for a religious or apostolic association or corporation if:
 - A. it has a common or community treasury, even if it engages in business for the common benefit of its members; and
 - B. the members include in their gross income their entire pro rata shares, whether distributed or not, of the taxable income of the association or corporation for the year.
2. Any amount included in the gross income of a member is to be treated as a dividend received.

[7.8.2] 27.2 (02-23-1999)

Legislative History

1. This provision dates back to the Revenue Act of 1936 and was added to the law for the following reasons:

"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 subjected to a fair tax." 80 Cong. Rec. 9074 (1936)

[7.8.2] 27.3 (02-23-1999) General Discussion

1. In general, the type of organization exempt under IRC 501(d) is one organized for the purpose of operating a communal religious community where the members live a communal life following the tenets and teachings of the organization. All of the organization's property is owned in community and, each member, upon leaving, the organization, is entitled to no part of the community assets. The activities often consist of farming and manufacturing. The income of the organization goes into a community treasury and is used to defray operating expenses and the cost of supporting and maintaining the members and their families. See Rev. Rul. 57- 574, C.B. 1957-2, 161.
2. A court test under this section involved Christ's Church of the Golden Rule. (Peggy Lou Riker et. al. v. Commissioner , 244 F.2d 220 (1957).) The church is devoted to the teaching and practice of Christianity in everyday life. Its principal reliance is on having its members live in a manner exemplifying Christ's teachings, particularly by living in a selfless manner. As a means of attaining its spiritual purposes, the church engages in commercial activities designed to permit the public to witness the application of Christ's teachings in everyday life. Its canon law provides that a commercial project may be owned in whole or in part by the church or an individual member of the church. In this particular case, a member of the church owned a restaurant which she managed as a church project. The restaurant was staffed by student ministers. The gross receipts were turned over to the church and the church paid all expenses. Neither the project manager nor the student ministers received a salary but received subsistence and living quarters from the church.
 - A. In holding that the church did not qualify for exemption under what is now IRC 501(d), the court said: "**** Congress intended [to exempt] 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 benefit of the members, as well as a common interest in the community treasury and property. The business benefit mentioned appears to be something more tangible and worldly than spiritual comfort though the common community enterprise is to be related to or associated with a religious group and doctrine, and being under the aegis of that group****"
3. In Twin Oaks Community, Inc. v. Commissioner , 87 T.C. 1233 (1986), the Tax Court rejected the Service position that the requirement for a common treasury or community treasury meant that members must take a vow of poverty and irrevocably contribute all of their property to the organization. The court held that a community treasury exists when all income that internally generated by the community operated business and all income derived by the organization from its property is placed in a common fund, and used for the maintenance and support of its

members, with all members having an equal undivided interest in the fund, but no right to claim title to any part of it.

4. In *Kleinsasser v. United States*, 707 F. 2d 1024 (1983), the 9th Circuit Court of Appeals made the following comments: "****The only requirements for the exemption are that there be a common treasury, that the members of the organization include pro-rata shares when reporting taxable income, and implicitly, that the organization have a religious or apostolic character. Once this requirement of form is fulfilled, the exempt organization is unlimited as to function****"

[7.8.2] 27.4 (02-23-1999)
Taxable Income Defined

1. Even though exempt from income tax, a religious or apostolic corporation or association must compute "taxable income" in order to determine the amounts its members will include in their gross incomes. "Taxable Income" means gross income minus the deductions allowed by Chapter 1 of the Code. See IRC 63(a). The entire pro rata share of the organization's "taxable income," which a member includes in his or her gross income, is treated as a dividend, as defined in IRM 316 and the implementing regulations, even though a portion thereof may be attributable to the sale or exchange of capital assets. See IRC 501(d). Accordingly, passthrough of the character of the corporation's income and any deductions is not allowed to the members.
2. In *Kleinsasser v. United States*, supra., the court held that members of an IRC 501(d) organizations are not entitled to an investment tax credit provided by IRC 38(a) on farm equipment and machinery purchased by the organization because IRC 501(d) organizations are not partnerships, and the property was not used in unrelated trade or business.

[7.8.2] 27.5 (02-23-1999)
Application for Exemption

1. There is no prescribed application form to be used by an organization seeking exemption under IRC 501(d). Any form of written application is acceptable as long as it is submitted to the District Director of Internal Revenue for the key district in which the principal office or principal place of business of the organization is located. For specific information concerning the required contents of an application, see Rev. Proc. 72-5, 1972-1 C.B. 709.

[7.8.2] 27.6 (02-23-1999)
Filing requirements for Religious and Apostolic Associations

1. Under Reg. 1.6033-2(e) and the filing instructions for Form 1065, a 501(d) organization is required to file a partnership return on Form 1065. As required by IRC 501(d), members report their pro rata share of the organization's income as a dividend on their individual tax returns.
2. The instructions for Form 1065 were modified in 1994 adding the following paragraph to the Form 1065 instructions:

"A religious or apostolic organization exempt from Income tax under section 501 (d) must file Form 1065 to report its taxable income, which must be allocated to its members as a dividend, whether distributed or not. Such an organization must figure its taxable income on an attachment to Form 1065 in the same manner as a corporation. Form 1120, U.S. Corporation Income Tax Return, may be used for this purpose. Enter the organization's taxable income, if any, on line 4b of Schedule K and each member's pro rata share on line 4b of Schedule K-1. Net operating losses are not deductible by the members but may be carried back or forward by the organization under the rules of section 172."

3. IRC 501(d) organizations are required to make their annual Form 1065 returns available for public inspection for three years after the return is due. IRC 501(d)'s are also required to make available a copy of their exemption application letters, any supporting documents, and their exemption letters. Failure to make these documents available for public inspection may subject

the organization to a penalty of \$20 per day for each day there is a failure to comply (up to a maximum of \$10,000 in the case of an annual return). See IRC 6104(e) and IRC 6652(c)(1)(C).

[7.8.2] 27.7 (02-23-1999)

Digests of Published Rulings and Procedures Relating to Religious and Apostolic Associations

1. Apostolic Organization--This ruling illustrates the type of organization that may qualify for exemption from federal income tax under IRC 501(d) and provides that contributions to such organizations are not deductible as charitable contributions for income tax purposes or for estate or gift tax purposes. Rev. Rul. 57-574, 1957-2 C.B. 161.
2. Applications--Information to be filed with exemption application by religious and apostolic organizations seeking exemption under section 501(d) of the Code. Rev. Proc. 72-5, 1972-1 C.B. 709.
3. Infants and minor children as members--To the extent allowed under applicable state law, parents may consent to membership on behalf of their minor children. Rev. Rul. 77-295, 1977-2 C.B. 196.
4. Organization supported by outside income--An organization supported by wages earned by members from outside employment, rather than from internally operated businesses, is not described in IRC 501(d). Rev. Rul. 78-100, 1978-1 C.B. 162.
5. An organization that is substantially dependent on wages earned by some of its members from outside employment does not qualify for exemption under IRC 501(d). Rev. Rul. 80-332, 1980-2 C.B. 34.
6. Contributions to IRC 501(d) organizations are not deductible by donors under IRC 170(c)(2). Under IRC 6113, any fundraising solicitation (including a solicitation for membership dues payment) that a 501(d) makes, must include an express statement (in a conspicuous and easily recognizable format) that contributions and gifts are not deductible as charitable contributions for federal income tax purposes. IRC 6113 does not apply, however, if the organization's annual gross receipts are normally \$100,000 or less, or if the organization's solicitations are made to no more than ten persons during a calendar year. The law provides penalties for failure to comply with this requirement, unless the failure is due to reasonable cause. Notice 88-120, 1988-2 C.B. 454.

**Internal Revenue
Manual**

**Hndbk. 7.8.2 Chap. 27 Religious and
Apostolic Associations**

**(02-23-
1999)**
