

Religious Organization Tax Exemptions



**ISSUE
MEMORANDUM
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Introduction

Various forms of tax exemptions to religious organizations exist throughout both state and federal law. This memorandum provides an overview of those exemptions. Wherever a court has been asked to resolve a question related to a specific exemption, this memorandum includes reference to the court's holding.

Federal Income Tax

A religious or apostolic association or corporation that has a "common treasure or community treasury" is exempt from federal income taxation, even if the association or corporation "engage[s] in business for the common benefit of the members [of that association or corporation]."¹ To qualify for exemption, each member must include his or her entire pro rata share of the association's or corporation's income in the member's gross income, even if the share is undistributed at the time.² The member's gross income is treated as a dividend and is taxed at the individual level.³

Property Taxes

The South Dakota Constitution requires the Legislature to exempt from taxation property that is used "exclusively" for religious purposes.⁴ In statute, therefore, property used by any "religious society" and "used exclusively for religious purposes" is exempt from taxation.⁵ In 1921, the South Dakota Supreme Court addressed the question of what constitutes a religious "purpose" within the language of the state constitution and statute when multiple buildings with different purposes exist on property

owned or leased by a religious society.⁶ The court followed a dissenting opinion from Illinois finding that the direct uses of buildings on land would not be determinative of their tax-exempt status, so long as all of the buildings together were for an overall "religious purpose."⁷ An organization's use of property to generate income will not alone cause the organization to lose an exemption.⁸

In 1986, the Legislature amended the exemption to apply to any building or structure used exclusively for religious purposes or to house any cleric of the religious society, to any lot owned by a religious society and used exclusively for parking vehicles, and an "educational plant" owned and operated by a religious society.⁹ The Act also added an alternative for a religious society or institution that owns property only partly used for religious purposes,¹⁰ proportionately reducing the value of the property to the amount of space and time the space is used for religious purposes.¹¹

Up to 80 acres of agricultural land owned by a religious society and used exclusively for religious purposes, and upon which any building or institution

¹ See [26 U.S.C. § 501\(d\)](#).

² See [26 C.F.R. § 1.501\(d\)-1](#).

³ See [26 C.F.R. § 1.501\(d\)-1](#).

⁴ See [S.D. CONST. art. XI, § 6](#).

⁵ See [§ 10-4-9](#).

⁶ See *State v. Erickson*, 182 N.W. 315 (S.D. 1921).

⁷ See *id.* at 319.

⁸ See [American Legion Home Assn. Post 22 v. Pennington County](#), 2018 S.D. 72 ¶ 30 (2018).

⁹ See 1986 S.D. Sess. Laws 300 (Ch. 83).

¹⁰ See 1986 S.D. Sess. Laws 302 (Ch. 83). See also *Lutherans Outdoors in S.D. v. S.D. State Bd. of Equalization*, 475 N.W.2d 140, 143 (S.D. 1991).

¹¹ See [§ 10-4-12](#).

is situated, is exempt from taxation.¹² Any other agricultural land owned by the religious society or institution is taxed “as other agricultural land” would be.¹³

Sales and Gross Receipts

State law provides an exemption to religious organizations for sales and gross receipts, with limitations. Receipts from a religious activity, which may include a bingo or lottery, are exempt from sales tax if the entire amount of receipts is expended for religious purposes and if they are not the result of business activity lasting more than three consecutive days.¹⁴ Receipts from a religious activity conducted at a county fair are exempt from sales tax if the receipts are expended on religious purposes and are not the result of business activity for more than five consecutive days.¹⁵

Gross receipts from room rentals at a lodging establishment or campground owned by a nonprofit religious organization are exempt from the tax on visitor-related businesses.¹⁶

Unemployment Contributions

The South Dakota Unemployment Compensation law gives benefits to qualified unemployed people out of a fund made up of contributions by employers. An “employer” means an employing unit that pays for service in employment wages of at least \$1,000 in a calendar year.¹⁷ If an organization does not pay for service in employment, the organization would

not meet the definition of employer under unemployment law.

The term “employment” is defined to include any service performed by an officer of a corporation or an individual who, “under the usual common-law (sic) rules applicable in determining the employer-employee relationship has the status of an employee.”¹⁸ Employment specifically includes state and local governments,¹⁹ religious organizations,²⁰ agriculture,²¹ and domestic service.²²

In order for services by an individual for a religious organization to be included as “employment,” the services must be exempt from the Federal Unemployment Tax Act and the organization must employ at least four employees for a specified period of time within a calendar year.²³ While the term “religious organization” is not defined, specific exemption from “employment” is provided for service performed by a person who is “in the employ” of a church or an organization supported by a church, and for services performed by a person who is a minister of a church.²⁴

Payroll Taxes

Under the Federal Insurance Contributions Act (F.I.C.A.), the federal government imposes an old-age, survivors, and disability insurance tax (Social Security) on the income of every individual.²⁵ The F.I.C.A. also imposes a hospital tax (Medicare).²⁶

An employee of a religious organization is not subject to social security taxation if the employing church or

¹² See [§ 10-4-10](#).

¹³ See [§ 10-4-10](#).

¹⁴ See [subdivision 10-45-13\(5\)](#).

¹⁵ See [subdivision 10-45-13\(9\)](#).

¹⁶ See [§ 10-45D-8](#).

¹⁷ See [§ 61-1-4](#).

¹⁸ See [§ 61-1-10](#).

¹⁹ See [§ 61-1-13](#).

²⁰ See [§ 61-1-15](#).

²¹ See [§ 61-1-18](#).

²² See [§ 61-1-19](#).

²³ See [§ 61-1-15](#). Service performed in the employ of a religious organization as defined under [26 U.S.C. § 501\(c\)\(3\)](#) that is exempt from federal income tax under [26 U.S.C. § 501\(a\)](#) is exempt from the federal unemployment tax. See [26 U.S.C. § 3306\(c\)\(8\)](#).

²⁴ See [§ 61-1-36](#).

²⁵ See [26 U.S.C. § 3101\(a\)](#).

²⁶ See [26 U.S.C. § 3101\(b\)](#).



qualified church-controlled organization elects to be excluded.²⁷ This election is available only to a church or qualified church-controlled organization that states that it is opposed to the social security tax for religious reasons.²⁸ The exclusion is not available to a church employee who works in a trade or business that is not “substantially related” to the church’s purpose or function.²⁹

Workers’ Compensation

Every employer and employee in South Dakota is “presumed” to have accepted the provisions of the South Dakota Workers’ Compensation Law,³⁰ which requires employers to provide compensation to employees injured at the workplace.³¹ The law limits employees to the remedies that are expressly provided.³²

An “employer” is a person who uses the service of another “for pay.”³³ An “employee” is a person in the service of another under a contract of employment, either express or implied.³⁴

Employers secure payment of compensation through insurance, reciprocal agreements with other employers, or by self-insuring.³⁵ The law provides no specific exemption for religious corporations, but does not apply to any corporation that does not fit the definition of employer or employee.

In 2009, Montana addressed the issue of religious corporations that do not participate in workers’ compensation.³⁶ The Montana Legislature amended

the definition of “employer” by including religious corporations that “receiv[e] remuneration from nonmembers for agricultural production, manufacturing, or a construction project conducted by its members on or off the property of the religious corporation.”³⁷ The Legislature also amended “employee” to include members of religious corporations subject to the newly defined “employer.”³⁸

Big Sky Colony, Inc., (“Colony”) a signatory to the Hutterian Brethren Church Constitution, sued the state, claiming that the newly amended law violated both the Free Exercise and Establishment clauses, as well as the corporation’s right to equal protection under the law.³⁹ The Montana Supreme Court found the changes did not indicate discriminatory intent against religious organizations.⁴⁰ The court also found state regulations of Colony’s compliance with workers’ compensation constituted valid regulation of commercial activities not in violation of the Establishment Clause.⁴¹ The court concluded the inclusion of “religious corporations” within workers’ compensation did not violate equal protection because religious corporations would not be subject to unequal treatment.⁴²

In 2015, Montana amended workers’ compensation again.⁴³ Under the new language, employers who are religious corporations are subject to the law if they receive remuneration from nonmembers for manufacturing or construction on or off property

²⁷ See [26 U.S.C. § 3121\(w\)\(1\)](#).

²⁸ See [26 U.S.C. § 3121\(w\)\(1\)](#).

²⁹ See [26 U.S.C. § 3121\(b\)\(8\)\(B\)](#). See also [26 U.S.C. § 513\(a\)](#) (defining “unrelated trade or business” for purposes of federal income tax).

³⁰ See [§ 62-3-3](#).

³¹ See [§ 62-3-1](#).

³² See [§ 62-3-2](#).

³³ See [§ 62-1-2](#).

³⁴ See [§ 62-1-3](#).

³⁵ See [§§ 62-5-2, 62-5-3](#), and [62-5-5](#).

³⁶ See [Big Sky Colony v. Montana Dept. of Labor and Industry, 291 P.3d 1231, 1234-5 \(Mont. 2012\)](#).

³⁷ See [2009 Mont. Laws, Ch. 112, § 6 \(HB119\)](#).

³⁸ See [2009 Mont. Laws, Ch. 112, § 7 \(HB119\)](#).

³⁹ See [Big Sky Colony, 291 P.3d at 1234](#).

⁴⁰ See [id. at 1240-1](#).

⁴¹ See [id. at 1244](#).

⁴² See [id. at 1245](#).

⁴³ See [2015 Mont. Laws, Ch. 364 \(SB258\)](#).



owned by the corporation, or for agricultural labor performed only off the property owned by the corporation.⁴⁴ (The previous language did not limit the agricultural labor to off-premises.)

In 2017, the South Dakota Legislature considered changes to the definitions of “employer,” “employee,” and “employment” under workers’ compensation.⁴⁵ The proposed language replicated

the Montana statutes, providing that an employment relationship includes “personal service” to a religious corporation, organization, or entity that receives “remuneration from nonmembers for manufacturing or a construction project” on or off the property of the religious corporation.⁴⁶ The Act was deferred to the 41st legislative day in the House State Affairs committee.⁴⁷

Conclusion

All states have some form of religious organization tax exemptions. The Supreme Court of the United States has held granting tax exemptions to religious organizations not to be “excessive entanglement” with religion under the First Amendment because the government does not transfer its revenue to a church, but “simply abstains from requiring the church to support the state.”⁴⁸ The Legislature, unless otherwise restrained or compelled by constitutional provisions, has plenary authority over the nature and extent of tax exemptions granted to religious organizations, subject to public policy considerations.

This issue memorandum was written by Wenzel J. Cummings, Senior Legislative Attorney, on November 9, 2018, for the Legislative Research Council. It is designed to provide background information on the subject and is not a policy statement made by the Legislative Research Council.

⁴⁴ See [id. at § 1](#).

⁴⁵ See [HB1093 \(2017\)](#).

⁴⁶ See [HB1093 \(2017\)](#).

⁴⁷ See 2017 HOUSE JOURNAL 368.

⁴⁸ See [Walz v. Tax Comm’n of City of N.Y., 397 U.S. 664 \(1970\)](#).

