

The Tax Code's "No Inurement" Limitation

Failure to meet certain conditions can jeopardize a church's exempt status.

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To be exempt from federal income taxation, a church must satisfy several conditions enumerated in section 501(c)(3) of the tax code. One of these conditions is that no part of a church's net earnings may "inure" to the personal benefit of an insider. A related condition is that a church cannot provide a substantial "private benefit" to anyone. It is important for church leaders to be familiar with these conditions since a violation jeopardizes a church's tax-exempt status. This article explains these requirements in light of the most recent precedent and identifies church practices that may violate one or both limitations.

Inurement defined

Section 501(c)(3) of the federal tax code exempts the following organizations from federal income tax:

Corporations, and any ... fund or foundation, organized and operated exclusively for religious, charitable ... or educational purposes ... *no part of the net earnings of which inures to the benefit of any private ... individual*, no substantial part of the activities of which is carrying on propaganda, or otherwise attempting, to influence legislation ... and which does not participate in, or intervene in (including the publishing or distributing of statements), any political campaign on behalf of (or in opposition to) any candidate for public office. (emphasis added)

The Internal Revenue Service (IRS) construes the inurement prohibition as follows:

Churches and religious organizations, like all exempt organizations under Internal Revenue Code section 501(c)(3), are prohibited from engaging in activities that result in inurement of the church's or organization's income or assets to insiders (i.e., persons having a personal and private interest in the activities of the organization). Insiders could include the minister, church board members, officers, and in certain circumstances, employees.

Examples of prohibited inurement include the payment of dividends, the payment of unreasonable compensation to insiders, and transferring property to insiders for less than fair market value. The

prohibition against inurement to insiders is absolute; therefore, any amount of inurement is, potentially, grounds for loss of tax-exempt status. In addition, the insider involved may be subject to excise tax Note that prohibite