Stephenson v. Commissioner, 79 T. C. 995 (1982)

Income cannot be excluded from taxation by claiming it was earned as an agent of a purportedly tax-exempt religious organization if that organization lacks legitimate structure and operations.

Summary

In Stephenson v. Commissioner, the Tax Court ruled that John Lynn Stephenson could not exclude his income by claiming he was an agent of a church he created, the Life Science Church of Allegan. The court found that the church lacked the organizational and operational structure required for tax-exempt status, and Stephenson's actions, including backdating documents and using church funds for personal expenses, were fraudulent attempts to evade taxes. The court upheld deficiencies for 1976 and 1977, denied charitable deductions and personal exemptions, and imposed fraud penalties under IRC section 6653(b).

Facts

John Lynn Stephenson, a physician, attended a meeting of the Life Science Church in late 1976. He paid $500 to the church and was ordained as a minister, receiving documents to establish his own church, the Life Science Church of Allegan. Stephenson executed a charter and vow of poverty on December 30, 1976, but evidence showed these documents were backdated, actually being created in early 1977. He transferred his residence to the church for $1 and opened a church bank account, using it for personal expenses. Stephenson worked at the Allegan Medical Clinic in 1976 and later as an independent contractor with Chelsea Emergency Physicians. He claimed his income was exempt from taxation as an agent of the church and filed a 1976 return excluding all income, while failing to file for 1977.

Procedural History

The Commissioner of Internal Revenue determined deficiencies and additions to Stephenson's tax for 1976 and 1977. Stephenson petitioned the Tax Court, which found that his church did not meet the organizational and operational tests for tax exemption under IRC section 501(c)(3). The court also found Stephenson's actions fraudulent, leading to the imposition of penalties under IRC section 6653(b).

Issue(s)

1. Whether Stephenson could exclude his income as an agent of the Life Science Church of Allegan or the Life Science Church.
2. Whether Stephenson was entitled to charitable contribution deductions for amounts transferred to the church.
3. Whether Stephenson was entitled to personal exemption deductions for his wife and children.
4. Whether Stephenson realized gain on the sale of his residence in 1977, and if so,

whether section 1034 allowed such gain not to be recognized.
5. Whether Stephenson was liable for additions to the tax for fraud under section 6653(b) for 1976 and 1977, and for failure to pay estimated income tax under section 6654 for 1977.

Holding

1. No, because the church was not a separate entity and Stephenson did not act as an agent of the Life Science Church.
2. No, because the church did not meet the organizational and operational tests for tax exemption under section 501(c)(3).
3. No, because Stephenson failed to provide evidence to support these deductions.
4. No, because the section 1034 rollover provision applied, preventing recognition of gain on the sale of the residence.
5. Yes, because Stephenson's actions, including backdating documents and using church funds for personal expenses, demonstrated fraudulent intent to evade taxes.

Court's Reasoning

The Tax Court analyzed the legitimacy of Stephenson's church, finding it did not meet the organizational test because its charter allowed assets to revert to Stephenson upon dissolution, and it failed the operational test as Stephenson used church funds for personal expenses. The court applied the rule from McGahen v. Commissioner that a church must be a separate entity to allow income exclusion, which Stephenson's church was not. The court cited Kelley v. Commissioner in rejecting Stephenson's agency claim with the Life Science Church. The court also found that Stephenson's actions, such as backdating documents and filing false forms, demonstrated fraudulent intent to evade taxes, as per Powell v. Granquist and Webb v. Commissioner.

Practical Implications

This decision underscores the importance of the organizational and operational tests for tax-exempt status and the need for a genuine separation between personal and church finances. It serves as a warning to taxpayers attempting to use religious organizations to evade taxes, highlighting the potential for fraud penalties. Practitioners should advise clients on the strict requirements for establishing a tax-exempt church and the severe consequences of fraudulent tax evasion. This case has been cited in subsequent rulings, such as Harcourt v. Commissioner and Solander v. Commissioner, reinforcing its impact on tax law regarding religious organizations.