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Gracias.

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Arizona Department of Economic Security

Appeals Board

Appeals Board No. T-1376182-001-B

ABOVE AND BEYOND
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Employer

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Department

IMPORTANT --- THIS IS THE APPEALS BOARD'S DECISION
The Department of Economic Security provides language assistance free of charge. For assistance in your preferred language, please call our Office of Appeals (602) 771-9036.

IMPORTANTE --- ESTA ES LA DECISIÓN DEL APPEALS BOARD
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RIGHT TO FURTHER REVIEW BY THE APPEALS BOARD

Under A.R.S. § 23-672(F), the last date to file a request for review is *** **January 20, 2015** ***.

DECISION
REVERSED

THE **EMPLOYER** petitioned for a hearing from the Department's Reconsidered Determination letter issued on August 6, 2012, which held in part as follows:

> ... we must conclude that [the Corporation] is not an organization operated primarily for religious purposes, as contemplated by A.R.S. § 23-615(6)(d)(i). Consequently,

> [the Corporation] is liable for Arizona Unemployment Insurance taxes as a non-profit 501(C)(3) organization which employed four or more employees. ...
>
> ... this Reconsidered Determination affirms the Determination of Unemployment Insurance Liability and the Determination of Liability for Employment or Wages issued November 18, 2011 ... and will become final unless a written petition for hearing is filed ...

The petition for a hearing having been timely filed, the Appeals Board has jurisdiction in this matter pursuant to A.R.S. § 23-724(B).

Prehearing conferences were conducted on October 10, 2013, and on April 29, 2014. Counsel for both parties attended both prehearing conferences, with witnesses or observers. No testimony was taken. **Board Exhibits 1 through 28** were admitted into evidence without objection. These Board Exhibits in evidence include memoranda submitted by both parties in response to specified questions relating to the hearing issues.

At the direction of the Appeals Board and following proper notice to all parties, a hearing was convened in Phoenix, Arizona before **ROBERT T. NALL,** an Administrative Law Judge on June 26, 2014. At that time, all parties were given an opportunity to present evidence regarding the following issues or contested points, as supplemented by the 12 questions listed in the prehearing conference notices:

1. Whether the August 6, 2012 Reconsidered Determination (Bd. Exh. 6) properly affirmed the November 18, 2011 DETERMINATION OF UNEMPLOYMENT INSURANCE LIABILITY (Bd. Exh. 2), and properly affirmed the November 18, 2011 DETERMINATION OF LIABILITY FOR EMPLOYMENT OR WAGES (Bd. Exh. 3).
2. Whether a pre-secondary school in Arizona can be an organization operated primarily for religious purposes and, if so, whether the Corporation in this case operates its schools primarily for religious purposes.
3. Whether the Department's currently-applied analysis of the standards applicable to ascertaining whether an organization is operated primarily for religious purposes, is an abuse of discretion when applied, after 2007, to church-affiliated schools based primarily upon the students' grade levels or age.
4. Whether the Corporation is an organization operated primarily for religious purposes at any time from inception to the present, as contemplated by former A.R.S. § 23-615(6)(d)(i).

5. Whether the involvement of the Church in creation and subsequent operation of the school is sufficient to establish that the school is operated primarily for religious purposes.

6. Whether the services performed by individuals as "Teachers, Teacher Aides, Substitute Teachers, Director, IT Personnel and Administrative Assistant" (Bd. Exhs. 2, 3, 6) constitute non-exempt employment, as defined by A.R.S. § 23-615.

7. Whether remuneration the Corporation paid to individuals as "Teachers, Teacher Aides, Substitute Teachers, Director, IT Personnel and Administrative Assistant" constitutes "wages", as defined by A.R.S. § 23-622.

8. Whether any of the individuals performing services as "Teachers, Teacher Aides, Substitute Teachers, Director, IT Personnel and Administrative Assistant" performed work that is exempt or is excluded from Arizona Unemployment Insurance (UI) coverage under A.R.S. §§ 23-613.01, 23-615, or 23-617, or under a decision of the federal government to not treat that individual, class of individuals, or similarly situated class of individuals as an employee or employees for Federal Unemployment Tax purposes.

9. Impact upon exempt employment status of the 501(c)(3) tax exempt status granted to the Corporation by the Internal Revenue Service, and impact of applicable licensure, bonding, or insurance requirements.

10. Whether distinguishing between schools that serve preschool aged children, or K-6 children, from schools that serve junior high, high school, or secondary school students, can be a proper standard for whether workers in such a school can properly receive different treatment regarding exempt employment status of workers and wages paid.

11. Whether the Department's citation (Bd. Exh. 6) to "... exempt employment as provided for under Arizona Revised Statute (A.R.S) § 23-615(6)(d)(i)" is significantly impacted by replacement of that language enacted June 19, 2013, to become the current wording in A.R.S. § 23-615(A)(7) and A.R.S. § 23-615(B)(1).

12. Whether the schools operated by the Corporation include educational and child care services that include religious instruction, and that is operated, supervised, controlled, or principally supported by a church or convention or association of churches as contemplated by A.R.S. § 23-615(b)(1). Further, whether the Corporation is an organization that is operated primarily for religious purposes.

Additional Board Exhibits 29 through 32 were admitted into evidence at the evidentiary hearing, without objection. Counsel for both parties appeared and presented arguments. Two witnesses for the Department testified, and ten witnesses testified on behalf of the Employer.

The APPEALS BOARD FINDS the following facts pertinent to the issues here under consideration:

1. The Employer was incorporated in Arizona as a non-profit corporation on March 26, 2003. Its incorporators also were directors or officers of an incorporated Church in Surprise, Arizona, which is a member of a convention or association of churches. The Employer was started or founded by the Church pastor. The Employer is a wholly owned subsidiary of the Church, according to the April 3, 2003 Arizona Joint Tax Application (Tr. pp. 98, 131; Bd. Exhs. 7-9, Bd. Exh. 22/LLL).

2. When incorporated, the Business Type was "EDUCATIONAL" on the Employer's joint application. The Articles of Incorporation specified its purposes (Tr. pp. 132, 196; Bd. Exhs. 7-9, 22/SSS):

> This corporation is organized exclusively for charitable, religious, educational and scientific purposes ... The character of business which the corporation initially intends to conduct will be to provide child care and preschool educational services, including Christian curriculum, in a Christian environment.

3. Upon application by the Employer to be exempt from Form 990 filing requirements, the U.S. Internal Revenue Service issued its January 11, 2011 letter stating its ruling (Bd. Exhs. 5, 22/UUU):

> ... we have determined that you meet the requirements for classification as a school below college level associated with a church as described in section 1.6033-2(g)(1) of the Treasury Regulations. ... you continue to be classified as an organization exempt from Federal income tax under section 501(c)(3) of the Code and classified as a public charity under sections 509(a)(1) and 170(b)(1)(A)(ii) of the Code.

4. Since its inception, the Employer has shared premises with the Church as it operates a preschool and a kindergarten through sixth grade (K-6) elementary school known as a "Christian School". A pilot program for seventh grade was cancelled within one year. The Employer borrowed funds from the

Church to construct or to obtain additional structures adjoining the Church buildings. The classrooms surround the Church sanctuary, so the students can "get into the church" from almost every classroom. (Tr. pp. 85, 97, 111, 118; Bd. Exhs. 5, 6).

5. On August 30, 2012, a trustee who serves both for the Employer and for the Church formally requested an Appeals Board hearing regarding the November 18, 2011 Determination of Liability for Employment or Wages, and the August 6, 2012 Reconsidered Determination. The Employer disputed the Department's assertion that the Employer is not exempt because it is not operated primarily for religious purposes, and specifically disputed the retroactive determination of Unemployment Insurance (UI) tax liability to October 1, 2008 (Bd. Exh. 10).

6. As of September 19, 2003, an investigation by the Department led to its written conclusion "... that the employer is an exempt 6 [in apparent reference to the subsection formerly cited as A.R.S. § 23-615(6)] based upon the fact that it is a preschool solely owned and operated by the church for church members", and incorporated for liability reasons. The Department's reviewer or auditor cited a policy that a separately incorporated organization operated, supervised, controlled or principally supported by a church or convention or association of churches operating as a pre-school not associated with other schools is exempt. Because the Employer previously had reported wages and had paid taxes, the Department cancelled the wage report and refunded the taxes paid. The Employer never "opted in" to become a covered employer, nor to become liable for payments in lieu of taxes under the optional payment election (Tr. pp. 59-62; Bd. Exhs. 6, 22/MMM).

7. After a former worker filed a claim for UI benefits, the Department initiated another investigation regarding her wages as a cook. On November 18, 2011, the Arizona Department of Economic Security issued its Determination of Liability for Employment or Wages and its Determination of Unemployment Insurance Liability at a tax rate of 2.00% beginning October 1, 2008 for 2008, 2009, 2010, and 2011. The Department included Notice of Assessment Reports for "Services performed by individuals as Teachers, Teacher Aides, Substitute Teachers, Director, IT Personnel and Administrative Assistant ... for the quarters ending 08/4-11/3" (Bd. Exhs. 1-6).

8. The Department's November 18, 2011 rulings relied upon its findings that the Employer "... is a daycare provider to the general public" and that: "Based on the financial records, [the Employer] does not meet the support is principally from the

church" (Bd. Exh. 1). The Employer filed a timely request for reconsideration, and thereby disputed the reasons explained in conversations by Department officials regarding "... the position that unless 50% or more of the income of a tax exempt entity comes directly from the affiliated church, the entity cannot be exempt under ..." A.R.S. 23-615(6)(d)(i), because the Church must provide the principal support of the separate entity (Tr. p. 58; Bd. Exhs. 1-6).

9. In response to the Employer's request, the Department's Chief of Tax issued a Reconsidered Determination dated August 6, 2012, which affirmed the November 18, 2011 determinations. However, the only basis expressed in the Reconsidered Determination was a conclusion that the Employer "... is not an organization operated primarily for religious purposes, as contemplated by A.R.S. § 23-615(6)(d)(i) and, thus, is liable for Arizona UI taxes as a non-profit 501(c)(3) organization which employed four or more employees." The Reconsidered Determination stated (Bd. Exh. 6):

> ... we conclude that the mission of [the Christian School] must first and foremost be the educational instruction of the students of a degree sufficient to ensure continuation in the education process ... Despite the religious goals or motivations of [the Employer], it is the primary activities ... that must be considered in determining exempt status. Here, the facts present demonstrate that the services provided by [the Employer] are primarily that of child care and the teaching of secular studies. Therefore, the exemption does not apply.

10. All directors of the Employer must be Church members. All teachers must present a statement of faith that is acceptable to the Employer's administration. The school curriculum for all ages is published by "A-BEKA BOOK", with virtually every page containing religious references and scripture. Every subject is infused with religious thought, consistently including references to purposeful divine creation. Every classroom has a Christian flag, Bible verses, a Bible displayed, and Christian emblems or decor (Tr. pp. 133-136, 143, 161, 182-184, 189).

11. Prayer, evangelism, godly behavior, and gospel or Christian music and lyrics are encouraged and incorporated into daily teachings for all student ages and for all employees. Scripture memorization is incorporated, starting in early preschool. Each school day includes group worship, and recitation of a Christian pledge in addition to a pledge of allegiance to the government. Under law and public policy, no such emphasis

and none of these religion-infused activities is permitted in secular public schools. (Tr. pp. 74, 75, 147, 149, 189).

12. In the schools operated by the Employer, certain required subjects and class time are purely religious. Each school day has time set aside for "Bible time". Other traditional subjects expressly are not discussed in a "secular way" (Tr. pp. 147-149, 165, 171; Bd. Exh. 22/H).

13. The school web sites also link to the Church web sites. By pamphlets and on its web sites, the school refers to its A-BEKA curriculum and publishes a Mission Statement as follows:

> To glorify God by partnering with families in our community to provide quality Christian preschool, education and development opportunities that will honor our Lord and Savior, Jesus Christ, among all nations.

The school slogans are as follows:

> **Ignite** A Passion for God's Word
> **Infuse** Young Minds with Education
> **Impact** A Community for Jesus

The preschool also describes itself as a licensed facility that opened on April 28, 2003, and which is a ministry of the Church located on the grounds of the Church (Tr. pp. 133-136, 186-191; Bd. Exhs. 22/E, 22/H).

14. Teachers and administrators consider their school participation to be a "ministry" and their purpose to be "evangelism". Multiple parents have enrolled their children with the Employer based upon a "faith comes first" philosophy. By their choice of the Employer's "Christian environment" for their children, parents may reject the options of lower-cost secular or public education, or home schooling (Tr. pp. 88, 102, 108, 116, 120, 127, 132, 137, 151, 161, 187, 191).

15. A significant portion of the tuition paid for students is given by the Employer to the Church (Tr. p. 193-195).

The Employer contends that, since its inception as a non-profit corporation, all of its employees have been engaged in "exempt employment" and, due to its religious nature and its primary focus upon religion, the Employer is exempt from the requirement to make compulsory contributions to the Unemployment Insurance system. The employment status of "Teachers, Teacher Aides, Substitute Teachers, Director, IT Personnel and Administrative Assistant", and the status of wages paid to them by the Employer, remain disputed in this case (Bd. Exhs. 7, 9, 26).

According to the Department's counsel, the Department based its ruling that the Employer is not exempt from Unemployment Insurance (UI) tax upon the Department's analysis that workers are not in the employ of an organization that is operated primarily for religious purposes (Tr. p. 10). The Department's counsel specified that "... the only issue is whether this entity ...", by operating a K through 6 school and a child care program, operates primarily for religious purposes (Tr. p. 11). A witness for the Department acknowledged that the analysis applies regardless of whether the education involved K through 6, junior high, or secondary school, but the analysis might be different if the Employer taught students who were at a college level (Tr. pp. 212, 213).

In its rulings and in its Reconsidered Determination, the Department has treated the Employer corporation as a whole. Thus, the Department did not make a distinction between the Employer's K-6 school, and the child care program for younger children. We also consider the organization as a whole. One of the Department's witnesses explained the view and analysis applied by the Department to both age groups:

> ... that if you are teaching general education subjects, even though there may be some religion [as part of] the school curriculum, ... the purpose is not primarily to religious instruction, it is primarily to teach general education and admit those kids because it's – it's impossible to help them move on ... to the next level. ... commonly understood that if you're teaching general education, that's your primary purpose ... if the primary purpose were to be religion and you're teaching only that, then you wouldn't care how well they do to get on to the next level ... We haven't had to go to the second test because we believe that the first test has not been met (Tr. pp. 42-44).

As an example of the rare situation when a separate organization clearly is operated primarily for religious purposes, one of the Department's witnesses discussed a group of parents who got together and formed a school at which a rabbi came to teach a few hours on Saturday, and after the regular school day. They taught Jewish religion, culture, and Hebrew language. Because they did not teach general education and had nothing to do with general studies, the Department's witness presented this as an example of a school that was deemed to be primarily for religious purpose (Tr. p. 48). The witness expressed his view that: "... if they're teaching general education, that's your primary purpose and not religious" (Tr. p. 49). Further, the witness expressed the Department's view of the 2013 change by the Arizona Legislature in the language of A.R.S. § 23-615, is that it does nothing to change either one of the two conditions upon exclusion. Although the Department's witness referred to "primarily nonreligious instruction" as a requirement, we construe his statements as

generally explaining that the change in statutory wording did not provide new, definitive guidance in evaluating the "primarily religious purpose" of a school (Tr. pp. 50, 51).

CONCEDED AND NOT AT ISSUE: Through its counsel, the Department expressly has conceded that the Employer "... is operated, supervised, controlled or principally supported by a church or convention or association of churches" (Tr. p. 10). The Department decided not to dispute that the Employer operates the school and child care while supervised, controlled, or principally supported by a church or convention or association of churches. Although the original Determinations were based upon the Employer's allegedly insufficient funding source or financial support connections with the Church, the Department's counsel stipulated that the Employer met that "prong" of the statutory tests for exemption. The Department's witness confirmed that the Employer's connection to the Church suffices, and is not a contested issue (Tr. pp. 10, 11, 30, 44).

PERTINENT LAWS: Arizona Revised Statutes, § 23-615 currently defines "employment" as follows, in pertinent part:

> A. "Employment" means any service of whatever nature performed by an employee for the person employing him, including service in interstate commerce, and includes:
>
> 1. An individual's entire service performed within or both within and without this state if:
>
> (a) The service is localized in this state. ...
>
> * * *
>
> 2. Services covered by an election pursuant to section 23-725.
>
> * * *
>
> 4. Service performed by any officer of a corporation.
>
> * * *
>
> 7. Service performed after December 31, 1971, by an individual in the employ of a religious, charitable, educational or other organization, but only if both of the following conditions are met:
>
> (a) The service is excluded from "employment" as defined in the federal unemployment tax act solely by reason of section 3306(c)(8) of that act.

(b) The organization had at least four individuals in employment for some portion of a day in each of twenty different weeks, whether or not the weeks were consecutive, within either the current or preceding calendar year, regardless of whether the individuals were employed simultaneously.

* * *

B. For purposes of subsection A, paragraphs 6, 7 and 8, the term "employment" does not apply to service performed for any of the following:

1. In the employ of a church or convention or association of churches, or an organization that is operated primarily for religious purposes, including educational and child care services that include religious instruction, and that is operated, supervised, controlled, or principally supported by a church or convention or association of churches.

2. By a duly ordained, commissioned or licensed minister of a church in the exercise of his ministry or by a member of a religious order in the exercise of duties required by the order. [Emphasis added].

* * *

From 1977 through September 13, 2013, similar provisions of Arizona Revised Statutes, § 23-615 were differently numbered and worded, in part as follows:

Employment

"Employment means any service of whatever nature performed by an employee for the person employing him, including service in interstate commerce, and includes:

* * *

6(d) For purposes of this paragraph, the term "employment" does not apply to services performed:

(i) In the employ of a church or convention or association of churches, or an organization which is operated primarily for religious purposes and which is operated, supervised, controlled, or principally supported by a church or convention or association of churches; or ...

(ii) By a duly ordained, commissioned, or licensed minister of a church in the exercise of his ministry or by a member of a religious order in the exercise of duties required by such order; or ...

* * *

Title 23 of the Federal Unemployment Tax Act, at 26 USCS § 2306, provides in part as follows:

Definitions

* * *

(c) Employment. For purposes of this chapter [26 USCS §§ 3301 et seq.], the term "employment" means any service performed ..., except

* * *

(8) service performed in the employ of a religious, charitable, educational, or other organization described in section 501(c)(3) [26 USCS § 501(c)(3)] which is exempt from income tax under section 501(a) [26 USCS § 501(a)]; ...

* * *

Federal law also provides in part as follows, at 26 USCS § 3309:

State law coverage of services performed for nonprofit organizations or governmental entities.

(a) State law requirements. For purposes of section 3304(a)(6) [26 USCS § 3304(a)(6)]--

(1) except as otherwise provided in subsections (b) and (c), the services to which this paragraph applies are--

(A) service excluded from the term "employment" solely by reason of paragraph (8) of section 3306(c) [26 USCS § 3306(c)], and

(B) service excluded from the term "employment" solely by reason of paragraph (7) of section 3306(c) [26 USCS § 3306(c)]; and

* * *

(b) Section not to apply to certain service. This section shall not apply to service performed--

(1) in the employ of (A) a church or convention or association of churches, (B) an organization which is operated primarily for religious purposes and which is operated, supervised, controlled, or principally supported by a church or convention or association of churches, or (C) an elementary or secondary school which is operated primarily for religious purposes, which is described in section 501(c)(3) [26 USCS § 501(c)(3)], and which is exempt from tax under section 501(a) [26 USCS § 501(a)];

(2) by a duly ordained, commissioned, or licensed minister of a church in the exercise of his ministry or by a member of a religious order in the exercise of duties required by such order;

* * *

Arizona Revised Statutes § 23-613.01(A) provides as follows:

Employee; definition; exempt employment

A. "Employee" means any individual who performs services for an employing unit and who is subject to the direction, rule or control of the employing unit as to both the method of performing or executing the services and the result to be effected or accomplished, except employee does not include:

1. An individual who performs services as an independent contractor, business person, agent or consultant, or in a capacity characteristics of an independent profession, trade, skill or occupation.

2. An individual subject to the direction, rule, control or subject to the right of direction, rule or control of an employing unit solely because of a provision of law regulating the organization, trade or business of the employing unit.

3. An individual or class of individuals that the federal government has decided not to and

does not treat as an employee or employees for federal unemployment tax purposes.

4. An individual if the employing unit demonstrates the individual performs services in the same manner as a similarly situated class of individuals that the federal government has decided not to and does not treat as an employee or employees for federal unemployment tax purposes. [Emphasis added].

Arizona Revised Statutes § 23-622(A) provides as follows:

Wages

A. "Wages" means all remuneration for services from whatever source, including commissions, bonuses and fringe benefits and the cash value of all remuneration in any medium other than cash. The reasonable cash value of remuneration in any medium other than cash shall be estimated and determined in accordance with rules prescribed by the department.

When analyzing a different statutory exception applicable to legislative bodies, the Arizona Court of Appeals summarized the pertinent law. A.R.S. § 23-615 defines "employment", for UI purposes, as any service of whatever nature performed by an employee for the person employing him. Certain exceptions are enumerated within the statute. If a statute's language is clear and unambiguous, the appellate court applies it without resorting to other methods of statutory interpretation. If more than one plausible interpretation of a statute exists, tools of statutory construction include considering the statute's context, its language, subject matter and historical background, its effects and consequences, and its spirit and purpose. *Robbins v. ADES*, 232 Ariz. 21, 300 P.3d 556 (2013). Legislative history becomes particularly pertinent when the Arizona Legislature recently has amended the relevant statute. *University Physicians Inc. v. Pima County*, 2007 Ariz. Tax LEXIS 16 (Arizona Tax Court 2007).

Effective in 2013, Arizona's Legislature amended its listing of those entitled to exemption by specifying services performed for "... an organization that is operated primarily for religious purposes, including educational and child care services that include religious instruction ...". The Employer indisputably is an educational and child care service that includes religious instruction. We conclude that the 2013 amendments to A.R.S. § 23-615 specifically add pertinent nuance to the terms: "operated primarily for religious purposes". The statutory

amendment clearly shows an intent, by statutory wording, to express that qualifying excluded services could include educational and child care services that offer religious instruction. No inconsistency with federal law is apparent. We infer the argument that any educational and child care services cannot possibly qualify, regardless of including religious instruction, because children of young age need lessons in secular subjects and require a safe environment, already has been addressed by the Arizona legislature. The potential to qualify expressly exists. Whether the Employer qualifies for the exemption it seeks, therefore, is a "proof" problem to be supported by credible evidence.

Arizona has not expressly included in its statute the third potential exemption of federal law, specifically: "(C) an elementary or secondary school which is operated primarily for religious purposes". 26 USCS § 3309(b)(1)(C).

Arizona case law includes analysis of "religion" under a different subsection of A.R.S. § 23-615, the same statute that controls the exception in this case. At issue was whether the teaching of religious materials could be the exercise of a ministry. In *Arizona College of Bible v. Department of Economic Security*, 120 Ariz. 217, 585 P.2d 237 (May 31, 1978), the Arizona Supreme Court held that the educational institution was improperly required to make wage reports and contributions under the Employment Security Act of Arizona. Specifically, a minister teaching religious subjects was not an employee but was acting in the exercise of a ministry. Under the formerly worded A.R.S. § 23-615(6)(d)(ii), a minister teaching a religious subject in a religious school can also be acting in the exercise of his ministry even though he is not conducting sacerdotal functions. The Court wrote:

> It is not the fact that they are ministers that is controlling, but the fact that they are ministers teaching religious subjects. Teaching of the Bible and Christian doctrine is and has been an exercise of a person's ministry throughout antiquity. The great religious leaders of the world have been teachers as well as leaders in religious services. We believe that teaching at the Arizona College of the Bible is an exercise of one's ministry.
>
> A similar argument can be made on behalf of a minister who chooses to exercise his ministry in the apparently secular function of an administrator of a religious educational institution. Even though the content of the work is not of the same religious nature as that of the teacher, both share the same ultimate goal, the religious purpose specifically articulated by the institution. It is unreasonable to say that a minister can only contribute his talents to such an institution in the classroom. In this situation, an administrator is also acting in the exercise of his ministry. [Emphasis added].

The Court quoted the A.R.S. § 23-615(6)(d)(i) subsection (as previously worded before September 2013), but because the reported facts involved licensed ministers and its ruling applied a different subsection, the Court declined the College's request to consider whether it was exempted under that subsection. *Arizona College of the Bible, supra.* We conclude that the ruling importantly refused to state that teaching cannot be an integral part of a ministry. We give weight to the Court's reasoning, and conclude the Court ruled the crucial analysis under Arizona law shall be that "the religious purpose specifically articulated by the institution" must be considered. In this case, we conclude that the Department did not give adequate weight to the religious purpose specifically articulated by the Employer, when making its ruling that the Employer could not be exempt regardless of its stated and actual religious purposes because its primary purpose as a school "... must first and foremost be the educational instruction of the students of a degree sufficient to ensure continuation in the education process" (Bd. Exh. 6).

Arizona is not alone in providing that the religious purpose articulated by an employing organization shall be considered. The Ninth Circuit Court of Appeals has held that although a non-profit humanitarian organization was neither owned by nor affiliated with a formally religious entity in the traditional sense, this did not preclude the court's finding that it was a primarily religious organization and thus eligible for the 42 U.S.C.S. § 2000e-1 exemption. *Spencer v. World Vision, Inc.*, 633 F.3d 723 (2011), *US Supreme Court certiorari denied* 2011 U.S. LEXIS 6689 (U.S., Oct. 3, 2011). The Court's opinion noted that:

> Congress extended the exemption to any "religious corporation, association, ... or society." 42 U.S.C. §2000e-1(a). If Congress had intended to restrict the exemption to "[c]hurches, and entities similar to churches" it could have said so. Because Congress did not, some religious corporations, associations, and societies that are not churches must fall within the exemption. ...
>
> As the United States argues as amicus, interpreting the statute such that it requires an organization to be a "church" to qualify for the exemption would discriminate against religious institutions which "are organized for a religious purpose and have sincerely held religious tenets, but are not houses of worship." ...
>
> Though our precedent provides us with the fundamental question—whether the general picture of World Vision is primarily religious—we must assess the manner in which we are to answer that question in the case at hand. Again, we are told that we must evaluate "[a]ll significant religious and secular characteristics." *EEOC v. Townley,* 859 F.2d 610 (9th Cir. 1988). ...

> In *Corp. of Presiding Bishop of the Church of Jesus Christ of Latter-Day Saints v. Amos*, 483 U.S. 327, 329 (U.S.1987), the Court found exactly this sort of inquiry problematic in the context of determining whether a particular employee's duties were religious or secular. There, the lower court had held that a "building engineer" at a church gymnasium performed a secular activity. 483 U.S. at 332. The Supreme Court reversed, explaining that to force an organization to "predict which of its activities a secular court will consider religious," would impose a "significant burden" and "might affect the way an organization carried out what it understood to be its religious mission." Id. at 336. As Justice Brennan wrote in concurrence,
>
> > ... determining whether an activity is religious or secular requires a searching case-by-case analysis. This results in considerable ongoing government entanglement in religious affairs. Furthermore, this prospect of government intrusion raises concern that a religious organization may be chilled in its free exercise activity. While a church may regard the conduct of certain functions as integral to its mission, a court may disagree. ...
>
> I believe the better approach can be summarized as follows: a nonprofit entity qualifies for the section 2000e-1 exemption if it establishes that it 1) is organized for a self-identified religious purpose (as evidenced by Articles of Incorporation or similar foundational documents), 2) is engaged in activity consistent with, and in furtherance of, those religious purposes, and 3) holds itself out to the public as religious. ...

A concurring opinion discussed religious schools, and proposed a fourth pertinent test that may be useful regarding the "primarily religious" issue:

> ... This discussion does not cover educational institutions, and religious schools may charge market rates as tuition. But they have their own phrase in the exemption, "educational institution," so they do not have to fall within the harder to define phrases in the exemption for "religious corporation, association, educational institution, or society." The inclusion of educational institutions suggests a more sensible *noscitur a sociis* reading of the exemption for "religious corporation, association, educational institution, or society." What they all have in common is that they are means by which

> people engage in the free exercise of their religions. Many religions have as central requirements that their adherents teach the religions to their children. Religious schools are how they do it, but they are often too expensive to operate supported out of charitable contributions, and need substantial tuitions. For the others, to determine whether the associations are religious or not for purposes of the exemption, what they charge for their services is an appropriate and usable test. For that matter, even if some educational institutions might otherwise be viewed as too secular in what they actually teach to qualify for the exemption, they would nevertheless be allowed by Congress to discriminate in hiring and employment by the alternative provision for schools "in whole or substantial part, owned, supported, controlled, or managed by a particular religion or by a particular religious corporation, association, or society."
>
> Accordingly, I would reformulate Judge O'Scannlain's test as this: To determine whether an entity is a "religious corporation, association, or society," determine whether it is organized for a religious purpose, is engaged primarily in carrying out that religious purpose, holds itself out to the public as an entity for carrying out that religious purpose, and does not engage primarily or substantially in the exchange of goods or services for money beyond nominal amounts. ...

We conclude that the Employer is "operated primarily for religious purposes", under the guidance provided by these essential aspects, which are both descriptive and indicative of religious nature. As evidence of its integration of faith and education, as well as its support from the Church, the Employer presented documents and testimony detailing its history, operations, and purpose. Exhibits included its mission statement, articles of incorporation, website, and curriculum. The Articles of Incorporation clearly express the Employer was organized "... exclusively for charitable, religious, educational and scientific purposes". These purposes were recognized by the Internal Revenue Service, which awarded the Employer 501(c)(3) status and an exemption from reporting, based upon its religious nature. The Employer's Mission Statement and slogan unequivocally express a thoroughly religious focus.

According to its counsel, the schools operated by the Employer unabashedly proselytize the children and their families. The Employer operates on premises occupied by the Church, and its directors must be Church members. Workers must present their Statements of Faith. Daily operations with children are pervasively religious in nature. The Employer's curriculum and class

operations are infused with religious faith and related statements of divine purpose, and secular context is avoided whenever possible. Clearly, the Employer was organized for religious purpose, is engaged thoroughly and primarily in carrying out that religious purpose, and holds itself out to the public as an entity for carrying out that religious purpose. The workers who testified considered themselves engaged in a ministry. The workers who testified willingly accept less-than-market wages in order to participate in the ministry. The parents who testified chose the Employer to educate their children for sincerely faith-based reasons, thereby eschewing readily available public, and secular schooling.

Although the Employer receives tuition, and student families may be eligible for educational tax credits, uncontradicted evidence established that the Employer shares with the Church a substantial portion of tuition, estimated at $6,000 to $7,000 per month. The Employer is wholly owned by the Church, which supports it financially and directs its operations. The Employer expressly is non-profit, and its incorporating documents mention nothing about generating income or any goal of maintaining net income. Although at least one former worker had cooking duties, nothing indicates that the Employer charges more than a nominal sum for hot lunches or any other items, including the "Spirit shirts" that are required for school functions. We conclude that the Employer is not engaged primarily in exchanging goods or services for money.

Regardless of the pervasively religious nature and purpose that the Employer has established through evidence, which includes calling itself a "Christian School", the Department repeatedly has contended that the teaching of secular subjects and the provision of a "safe environment" must be a school's primary purpose in light of the student ages. Obviously, any K-6 school is required by law to teach some of the same subjects addressed by a public or secular school education. The preschool is licensed by an Arizona agency and, therefore, must meet certain standards. However, the record is equally clear that a public or secular school is prohibited by law or by public policy from even mentioning many of the religion-based concepts that form the bedrock foundation of the Employer's daily emphasis and activities. Prayer, scripture, and pervasive references to divine purpose are not part of the public school structure, due to the Establishment clauses in the United States and Arizona Constitutions, the impacts of which were exhaustively discussed by the Courts in *Amos, supra* and in *Spencer v World Vision, supra.*

The legislature's taxing authority is very broad. Setting tax rates is a legislative function. Therefore, courts extend considerable deference and great latitude to the legislative creation of "classifications and distinctions in tax statutes." In holding that tuition credits are a legitimate legislative option even if benefits flow to private schools or sectarian schools, the Arizona Supreme Court discussed the Establishment Clause, constitutional interpretation, and the impact of Legislative action upon religious freedoms. *Kotterman v. Killian*, 193

Ariz. 273, 972 P.2d 606 (1999). The Court noted that Arizona's framers did not hesitate to extend tax-exempt status to churches. *See,* Ariz. Constitution Article IX §§ 2(2), 7, 10, and 12. In fact, the framers uniformly supported property tax exemptions for all "religious associations or institutions not used or held for profit." The Court added: "Clearly, these exemptions constitute benefits to religious organizations, suggesting either that the framers did not regard such tax-saving measures as direct grants of 'public money,' or that their intent in prohibiting aid to religious institutions was not as all-encompassing as petitioners would have us hold." The analysis included:

> In fact, as we review Arizona history and scan the present day horizon, it is apparent that religion has never been hermetically sealed off from other institutions in this state, or the nation. *See, e.g., Bauchman v. West High Sch.*, 132 F.3d 542, 554 (10th Cir. 1997) ("Courts have long recognized the historical, social and cultural significance of religion in our lives and in the world, generally."). Arizona's motto, *Ditat Deus*, means "God enriches." *See*, Ariz. Const. art. XXII, § 20. And even though, as we have noted, the transcripts of our constitutional convention reveal almost nothing about the clauses in question, they clearly reflect religion as part of the proceedings. Each day's session was opened by a prayer from the convention chaplain, Rev. Seaborn Crutchfield. Indeed, to this day Arizona legislative sessions begin with a prayer delivered by the Chaplain of the Day. The constitutional delegates also negotiated over whether the preamble should refer to "Almighty God," the "Supreme Being," or "Almighty God for Liberty." Records, at 41, 77, 82-83. They ultimately agreed that the preamble should read, "We, the people of the State of Arizona, grateful to Almighty God for our liberties, do ordain this Constitution." *Id.* at 1399.
>
> In a more contemporary vein, tax codes, both state and federal, permit churches and other religious institutions to acquire tax-free status and allow deductions for contributions made directly to such entities. *See*, 26 U.S.C. §§ 501(a), (c)(3), 170(a), (c)(2)(B); A.R.S. §§ 43-1201, 43-1042. "The doctrine of separation of church and state does not include the doctrine of total nonrecognition of the church by the state and of the state by the church." *Community Council v. Jordan*, 102 Ariz. at 451, 432 P.2d at 463.
>
> Clearly, the state constitution forbids the creation of a state church or religion. It also guarantees freedom of worship and belief by demanding absolute neutrality in

> the treatment of religious groups. "The State is mandated by [article II, § 12] to be absolutely impartial when it comes to the question of religious preference, and public money or property may not be used to promote or favor any particular religious sect or denomination or religion generally." *Pratt v. Arizona Bd of Regents,* 110 Ariz. 466, 468, 520 P.2d 514, 516 (1974). There is no evidence, however, that the framers intended to divorce completely any hint of religion from all conceivably state-related functions, nor would such a goal be realistically attainable in today's world.

Based upon the credible and probative evidence of record, we concur whole-heartedly with the analysis of the "operated primarily for religious purposes" phrase, as discussed by the Court in *Unity Christian School of Fulton v. Rowell*, 2014 IL App (3d) 120799, 6 N.E.3d 845 (March 11, 2014). In that case, the Illinois Department of Economic Security Director had determined that the school was not entitled to an exemption, having found that the school was separately incorporated and autonomous. Furthermore, the official determined that "[t]he preponderance of the evidence is that [Unity's] curriculum is primarily secular in nature, although religious subjects are taught."

The Illinois court noted that the majority of cases interpreting section 211.3(A) of the Illinois Act or its federal counterpart section 3309(b)(1)(B), which the Illinois legislature adopted verbatim, have hinged upon a determination of what constitutes "operated, supervised, controlled or principally supported by a church," sidestepping any discussion about what Congress meant regarding operating "primarily for a religious purpose." The Illinois court cited several such cases in multiple jurisdictions, and also cited *St. Martin Evangelical Lutheran Church v. South Dakota*, 451 U.S. 772, 783, 101 S. Ct. 2142, 68 L. Ed. 2d 612 (1981), as analyzing the corresponding provisions of the Federal Unemployment Tax Act, 26 U.S.C. §§ 3301-3311 (1976 & Supp. III).

In *Unity Christian School of Fulton, supra,* the Court addressed facts very similar to the findings in this case, including incorporation separate from any affiliate churches. The Court articulated its reasoning as follows regarding the "primarily for a religious purpose" issue:

> We decline at this point to expound an all-inclusive definition of what constitutes a religious purpose within the context of elementary and secondary religious schools. Yet, as it stands now, we cannot fathom a different primary purpose other than religion in Unity's case. ... The Department argues that "[w]ithout demonstrating that the majority of class time was spent on religious instruction as opposed to secular topics such as

> mathematics, grammar, or science, Unity could not possibly prove that it was operated primarily for a religious purpose." This argument defies reality. Under this construct, no separately organized parochial school would be subject to exemption.
>
> The Department's argument ignores the fact that a school that is not an institution of higher education is required to teach secular subjects. *See* 105 ILCS 5/27-1, 27-22 (West 2006). Only some types of preseminary or novitiate schools would likely qualify for exemption under the Department's strict and narrow reading of the Act. Why would the General Assembly incorporate an exception that is unobtainable? By the Department's reasoning, only grade or high schools devoting the majority of class time to religious instruction would be exempt from the state's unemployment system, but those schools would simultaneously be violating the law. If the parents of Unity's students wanted them to attend a school that did not incorporate the principles of their Christian faith, they would simply send them to public schools. Even according to its constitution, Unity's principal goal is to incorporate faith into the everyday life and education of its students. Under the current state of the law, this cannot be achieved in a public school. Religion is Unity's *raison d'être*.
>
> The Department's conclusion was based on a finding that Unity's "curriculum is primarily secular in nature." Well, of course it is. Just like the curricula in every other parochial school in the state. But the primary purpose of the school is to teach those secular subjects in a faith-based environment.
>
> We, therefore, find that Unity is operated for primarily religious purposes. The fact that secular subjects are necessarily taught makes that no less true. The Department's finding to the contrary is clearly erroneous. ... Yet, the Department's decision must be confirmed. As explained below, it is clear from the record that the school failed to prove that it was operated, supervised, controlled or principally supported by a church or convention or association of churches.

Both Congress and the Arizona Legislature enacted laws that made exemption possible for schools that include religious instruction. The mixed issue of fact and law in this case, therefore, is whether the Employer established that it is an organization that is operated primarily for religious purposes. The

other "prong" of the statutory exemption has been conceded by the Department, through counsel. Every witness presented by the Employer credibly testified that the primary purpose of its operations is religious in nature. Thus, the perspectives of the Church that organized and has controlled the Employer, parents who choose the school, the administration, and teachers were presented.

Inclusion of employers and workers in the Employment Security Law of Arizona carries both benefits and responsibilities. Many courts have recognized that the unemployment compensation system has value to individuals through compensating employees of church-related schools who lose their jobs. Courts also have recognized that the system treats all employers equally. *See, Ascension Lutheran Church v Employment Security Commission of North Carolina*, 501 F.Supp. 843, 846 (D.C.N.C. 1980).

However, the Employer seeks an exclusion to which it is entitled because its operations meet the exclusion criteria specified by statute. As the *Unity Christian School of Fulton* court so capably explained, denying the requested exclusion on the grounds that the school must include secular subjects and, therefore, its primary operating purpose cannot be religion, would make meaningless and unnecessary any existence of the statutory exceptions that have been enacted. We conclude that the exceptions must be given life, vitality, and meaning for:

- "an organization that is operated primarily for religious purposes, including educational and child care services that include religious instruction, and that is operated, supervised, controlled, or principally supported by a church or convention or association of churches", under Arizona's recently modified and current law,
- "... or (C) an elementary or secondary school which is operated primarily for religious purposes", as provided by the federal law.

We conclude that the Employer presented evidence sufficient to establish that it is operated primarily for religious purposes. Having established that it operates an elementary or secondary school that includes religious instruction, which is operated primarily for religious purposes, and which is materially operated, supervised, controlled, or principally supported by a church, the Employer qualifies for the statutory exemption from "employment" status.

The "Teachers, Teacher Aides, Substitute Teachers, Director, IT Personnel and Administrative Assistant" (Bd. Exhs. 2, 3, 6) are engaged in exempt employment for the Employer, as defined by A.R.S. § 23-615. Any remuneration the Employer pays to individuals as "Teachers, Teacher Aides, Substitute Teachers, Director, IT Personnel and Administrative Assistant" does not constitute "wages", as defined by A.R.S. § 23-622. Accordingly,

THE APPEALS BOARD **REVERSES** the Department's Reconsidered Determination dated August 6, 2012.

The term "non-exempt employment" does not apply to the Employer, which is a non-profit 501(c)(3) "... organization that is operated primarily for religious purposes, including educational and child care services that include religious instruction", as contemplated by A.R.S. § 23-615(A)(7) and 23-615(B)(1), formerly A.R.S. § 23-615(6)(d)(i).

The Employer is an organization that is "... operated, supervised, controlled, or principally supported by a church or convention or association of churches", as contemplated by A.R.S. § 23-615(A)(7) and 23-615(B)(1), formerly A.R.S. § 23-615(6)(d)(i).

THE APPEALS BOARD **SETS ASIDE** the Department's Determination of Unemployment Insurance Liability and the Determination of Liability for Employment or Wages issued November 18, 2011.

THE APPEALS BOARD **REMANDS** the matter to the Department's Unemployment Tax Section for further action consistent with this ruling.

DATED: 12/19/2014

APPEALS BOARD

Gary R. Blanton

GARY R. BLANTON, Chairman

Janet L. Feltz

JANET L. FELTZ, Member

William G. Dade

WILLIAM G. DADE, Member

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take part in a program, service or activity. For example, this means if necessary, the Department must provide sign language interpreters for people who are deaf, a wheelchair accessible location, or enlarged print materials. It also means that the Department will take any other reasonable action that allows you to take part in and understand a program or activity, including making reasonable changes to an activity. If you believe that you will not be able to understand or take part in a program or activity because of your disability, please let us know of your disability needs in advance if at all possible. To request this document in alternative format or for further information about this policy, please contact the Appeals Board Chairman at (602) 771-9036; TTY/TDD Services: 7-1-1. • Free language assistance for DES services is available upon request.

HOW TO ASK FOR REVIEW OF THIS DECISION

A. Within 30 calendar days after this decision is mailed to you, you may file a written request for review. We consider the request for review filed:

1. On the date of its postmark, if mailed through the United States Postal Service (USPS).
   - If there is no postmark, the postage meter-mark on the envelope in which it is received.
   - If not postmarked or postage meter-marked or if the mark is not readable, on the date entered on the document as the date of completion.
2. On the date it is received by the Department, if not sent by USPS.

You may send requests for review to the Appeals Board, 1951 W. Camelback Road, Suite 465, Phoenix, AZ, 85015, or to any public assistance office in Arizona. You may also file a written request for review in person at the above locations.

B. You may represent yourself or have someone represent you. If you pay your representative, that person either must be a licensed Arizona attorney or must be supervised by one. Representatives are not provided by the Department.

C. Your request for review must be in writing, signed by you or your representative and filed on time. The request for review must also include a written statement which:

1. explains why the Appeals Board decision is wrong,
2. cites the record, rules and other authority, and
3. refers to specific hearing testimony and evidence.

D. If you need more time to file a request for review, you must apply to the Appeals Board before the appeal deadline and show good cause.

Call the Appeals Board at (602) 771-9036 with any questions

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