

Audit Technique Guide for Religious Organization

Introduction

This guide contains specific audit guidelines and techniques for Internal Revenue Code (IRC) Section 501(c)(3) religious organizations, other than churches. These guidelines are not all-inclusive. This discussion supplements the guidelines in:

- IRM 4.75.10, Exempt Organizations Pre-Audit Procedures
- IRM 4.75.11, On Site Examination Guidelines
- IRM 4.75.12, Required Filing Checks
- IRM 4.75.13, Issue Development

For detailed technical information, see [IRM 7.25.3, Religious, Charitable, Educational, Etc., Organizations](#). If the organization claims to be a church, follow the procedures in IRC Section 7611.

The term “agent” refers to the EO employee assigned to the case, regardless of his/her job series.

Religious Organizations – Overview

IRC Section 501(c)(3) gives exemption to entities organized and operated exclusively for “religious” purposes. Because activities often serve more than one purpose, an organization “advancing religion” (Treas. Reg. 1.501(c)(3)-1(d)(2)), may also qualify under IRC Section 501(c)(3) as a charitable organization.

Any religious organization must satisfy the statutory requirements to be exempt under IRC Section 501(c)(3). There are various types of institutions that are regarded, for federal tax purposes, as religious organizations. These include churches, conventions and associations of churches, integrated auxiliaries of churches, religious orders, and apostolic organizations.

The First Amendment prohibits the Government from restricting the free exercise of religion. The courts have held that the First Amendment provides for an absolute freedom of religious belief. However, actions undertaken due to religious beliefs are subject to government regulation when those actions implicate a compelling government interest. Religiously motivated conduct that violates federal, state, or local law may be restricted or prohibited entirely.

Under the First Amendment, the IRS can’t:

- Consider the content or sources of a doctrine alleged to constitute a particular religion.
- Evaluate the content of a doctrine an organization claims is religious. This doesn’t apply to rites or practices that violate federal, state or local law.

The term “church” includes an order or an organization if the order or organization is an integral part of a church under IRC Section 6033 and Treas. Reg. 1.6033-2(h). If the organization claims to be or appears to be a church, refer to [IRM 25.5.8.3.1\(1\)](#).

Specific Audit Objectives for Religious Organizations

Determine, during the audit if the organization’s activities further religious or other exempt purposes. Verify that it meets the requirements of IRC Section 501(c)(3). Consider:

- Inurement

- Private benefit
- Substantial legislative activities
- Political activities
- Operation primarily for business purposes
- Operation in a commercial manner

Note: IRM 7.25.3 discusses the requirements for exemption under IRC Section 501(c)(3).

Use these additional audit procedures for any IRC Section 501(c)(3) religious organization audit:

- Determine that the organization is both organized and operated for IRC Section 501(c)(3) purposes.
- Ensure the organization operates for public purposes rather than private interests.
- Determine whether the organization engages in any substantial nonexempt activity, such as trade or business, social or recreational activities.
- Ensure the organization's assets are permanently dedicated to IRC Section 501(c)(3) purposes.
- Evaluate the organization's procedures to account for funds disbursed to individuals or non-IRC Section 501(c)(3) organizations.
- Determine if the organization pays, directly or indirectly, any excessive compensation, fees, allowances, or taxable benefits.
- Determine whether the organization has participated in any substantial legislative activities.
- Determine whether the organization has intervened in any political campaign on behalf of or opposition to any candidate for public office.
- Verify the organization's foundation status.

Pre-Audit Procedures for Religious Organizations

Check IDRS (command code INOLES) for a cross reference Employer Identification Number (EIN). Use INOLES, BMFOLE/ENMOD, and/or BMFOLO to view the exempt status (or lack) of any cross reference entity. Any cross-referenced entity may be a church.

Conduct the package audit on IDRS via command code BMFOLI. Check for:

- Form 990-T, Exempt Organization Business Income Tax Return
- Form 941, Employer's Quarterly Federal Tax Return

If you find unusual returns, such as the following, deem them unusual and include them in your audit:

- Form 11-C, Occupational Tax and Registration Return for Wagering
- Form 945, Annual Return of Withheld Federal Income Tax
- Form 720, Quarterly Federal Excise Tax Return
- Form 730, Monthly Tax Return for Wagers
- Form 2290, Heavy Highway Vehicle Use Tax Return

Get the determination file from Cincinnati. Review the organization's articles of incorporation or other organizing document to ensure the organization:

- Is organized exclusively for IRC Section 501(c)(3) purposes per Treas. Reg. 1.501(c)(3)-1(b).
- Permanently dedicates its assets to IRC Section 501(c)(3) purposes per Treas. Reg. 1.501(c)(3)-1(b).

If the organization has a website, look for:

- Evidence of an exempt religious purpose
- Indications of political activity
- Indications of non-exempt purposes or activities
- Contact information for the officers

Review the Form 990, Return of Organization Exempt From Income Tax or Form 990-EZ, Short Form Return of Organization Exempt From Income Tax. Look for:

- Descriptions of activities other than religious activities
- Unusual sources of income, such as sales of inventory or gaming
- Unusual expenses, such as professional fundraiser fees
- Unusual position titles for key employees
- Questionable responses to the yes/no questions
- Unusual independent contractor services
- Missing schedules and statements
- Other large, unusual or questionable items

Note: Forms 990-N, Electronic Notice (e-Postcard) for Tax-Exempt Organizations Not Required to File Form 990 or Form 990-EZ don't have a lot of information. During the field audit, verify all information reported.

Note: For exceptions to the Form 990 filing requirement, including integrated auxiliaries of churches, see Annual Exempt Organization Return: Who Must File on IRS.gov. For information on integrated auxiliaries of churches, see Pub. 1828, Tax Guide for Churches & Religious Organizations.

Check Online Statistics of Income Exempt Organization Return Imaging Net (SEIN) for prior and subsequent years Forms 990 or Forms 990-EZ. Look for the items noted above. (EO Select Check provides information from filed Forms 990-N.)

Check Online SEIN for related Forms 990-T, if not present in RCCMS (Reporting Compliance Case Management System). Determine the following:

- What is the income source?
- Are there large, unusual, or questionable expenses?
- Does a type of expense appear in more than one place?
- Do the total expenses match the Form 990 total expense amount?
- Are there net operating losses?

See IRM 4.75.10, Exempt Organizations Pre-Audit Procedures, for additional procedures.

Field/Office Correspondence Procedures

Follow the audit steps below and use these IRM sections:

- IRM 4.75.11, On Site Examination Guidelines
- IRM 4.75.12, Required Filing Checks
- IRM 4.75.13, Issue Development

Review the minutes of the board of directors, brochures, and other publications. Determine whether the organization:

- Engages in lobbying or political activities or supports candidates for public office.
- Sponsors public forums or invites candidates for political events.
- Engages in exclusively IRC Section 501(c)(3) activities.
- Engages in any activities that violate public policy, such as, illegal activities.

Review the financial books and records, contracts and agreements. Determine if the organization engages in any of the following kinds of transactions or activities:

- Excess benefit transactions (IRC Section 4958)
- Other transactions generating inurement or private benefit
- Lobbying or other attempts to influence legislation
- Participation or intervention in a political campaign on behalf of, or in opposition to, a candidate for public office
- Donations to political candidates for office
- Unrelated trades or businesses
- Fundraising

Publishing literature is an important method of disseminating religious views. Publishing may also be a business operating in competition with commercial enterprises. Consider the following in determining whether or not the activity is an unrelated business:

- Does the organization charge fees for its services and/or publications? If so, secure a schedule of fees charged.
- Does the organization operate a bookstore?
- Does the organization engage in publishing activities of any nature?
- What is the nature of the operations?
- Does the organization make sales to the general public?
- What kind of literature is involved?
- How do such activities further the organization's exempt purposes?
- Does the organization have literature of its own? If so, secure a list of several of the chief works, giving the author and title.
- Who selects any publishing projects and how are they selected?
- What are the criteria used for making selections?
- How are the publishing activities distinguishable from those of a for-profit enterprise?
- Is the literature distributed free of charge? If not, what basis is used in determining the sales price?
- How does the organization distribute the literature?
- Is the literature copyrighted? If so, in whose name will the copyright be held?

Broadcasting is an activity analogous to publishing. Determine:

- How the broadcasting activities further its exempt purposes.
- How the broadcasting activities are distinguishable from those of a for profit enterprise.

Case Closing Procedures

Cases involving IRC Section 501(c)(3) religious organizations can be closed as:

- No change/no change with advisory

- Agreed/unagreed foundation status modification
- Agreed/unagreed revocation
- Agreed/unagreed tax assessment
- Delinquent related return secured

For cases involving no change/no change with advisory, refer to:

- IRM 4.75.15.5, No Issues
- IRM 4.75.15.6, Issues Under Tolerance (Written Advisory)
- IRM 4.75.16, Case Closing Procedures, for the applicable closing letter and case closing procedures.

For foundation status modifications, see:

- IRM 4.75.15.8.3, Reclassification of Foundation Status, for the audit report procedures
- IRM 4.75.16.6, Cases Subject to Mandatory Review, for cases closed to Mandatory Review.

For revocations, see:

- IRM 4.75.15.8.3, Revocations, for the audit report procedures
- IRM 4.75.16.6, Cases Subject to Mandatory Review, for cases closed to Mandatory Review.

For proposed tax assessments, see the following sections for the appropriate audit report procedures:

- IRM 4.75.15.8.5, Unrelated Business Income Tax (UBIT)
- IRM 4.75.15.8.6, Employment Taxes
- IRM 4.75.15.8.8, Non-Private Foundation Excise Taxes

For secured delinquent returns, see IRM 4.75.22.4, Delinquent Return Received. If you don't open the secured delinquent return for audit, and the case doesn't involve code section modifications, revocations, or unagreed tax assessments, close the case. If opened for audit, close the case as either a no change (delinquent return secured), agreed tax change, or unagreed tax change.