

B. UPDATE ON CHURCHES AND OTHER RELIGIOUS ORGANIZATIONS

1. Introduction

The 1978, 1979, and 1980 EOATRI textbooks contain discussions on issues involving the tax exempt status of churches and other religious organizations. The purpose of this article is to discuss the court cases that were decided in 1980. Generally, these cases involved the following issues:

- Definition of church
- Standing to sue for declaratory judgment under IRC 7428; Exhaustion of Administrative Remedies
- Nonexempt activities
- Burden of Proof
- Summons Enforcement
- Inurement and Private Benefit

2. Definition of Church

It is important to bear in mind that not all tax exempt religious organizations qualify as "churches" within the meaning of IRC 170(b)(1)(A)(i). Classification as a church, however, entails several significant advantages. For example, churches are not subject to the IRC 508 notice requirements, do not have to file information returns under IRC 6033, and have the benefit of the IRC 7605(c) pre-examination rules. To obtain these advantages, religious organizations often seek classification as IRC 170(b)(1)(A)(i) churches. Moreover, mail-order ministries often seek church classification since they believe that it is the best way to avoid taxes.

In American Guidance Foundation, Inc. v. U.S., 80-1 USTC 9452 (D.D.C. 1980), an IRC 501(c)(3) religious organization, the American Guidance Foundation (AGF), sought classification as a church. (AGF had previously been classified as a private foundation.) Throughout its existence, AGF's membership had consisted of a married couple and their immediate family. The founder

ministered to this "congregation" through worship services conducted in his apartment. AGF also had recorded religious messages on tape.

The court observed that Congress has offered virtually no guidance as to precisely what is meant by the term "church," and that, faced with the difficult task of determining whether or not religious organizations are in fact churches, the IRS has developed fourteen criteria which it applies on an ad hoc basis to individual organizations. (It should be noted that the IRS has never officially committed itself to the fourteen criteria.) The criteria are as follows:

- (1) a distinct legal existence
- (2) a recognized creed and form of worship
- (3) a definite and distinct ecclesiastical government
- (4) a formal code of doctrine and discipline
- (5) a distinct religious history
- (6) a membership not associated with any other church or denomination
- (7) an organization of ordained ministers
- (8) ordained ministers selected after completing prescribed studies
- (9) a literature of its own
- (10) established places of worship
- (11) regular congregations
- (12) regular religious services
- (13) Sunday schools for religious instruction of the young
- (14) schools for the preparation of its ministers

The court analyzed these criteria as follows:

While some of these [criteria] are relatively minor, others, e.g. the existence of an established congregation served by an organized ministry, the provision of regular religious services and religious education for the young, and the dissemination of a doctrinal code, are of central importance. The means by which an avowedly religious purpose is accomplished separates a "church" from other forms of religious enterprise...

At a minimum, a church includes a body of believers or communicants that assembles regularly in order to worship. Unless the organization is reasonably available to the public in its conduct of worship, its educational instruction, and its promulgation of doctrine, it cannot fulfill this associational role.

Applying this analysis to the case at hand, the court determined that AGF was not a church. In making this determination, the court concluded that a married couple praying together in the physical solitude of their home did not constitute a "congregation" within the ordinary meaning of the word, and that AGF had made no real effort to convert others or to extend its membership beyond the immediate family of the founder. Also, AGF's use of recorded religious messages on tape "hardly qualifies as dissemination of a creed or doctrine." In short, SGF was engaged in a private religious enterprise, and therefore could not fulfill the associational role normally associated with the term "church." This case should serve as a useful precedent in dealing with those cases involving religious organizations claiming church status that consist of little more than members of one family.

3. Standing to sue for a Declaratory Judgment under IRC 7428; Exhaustion of Administrative Remedies

In American New Covenant Church v. Commissioner, 74 T.C. 22 (5-19-80), the Tax Court considered the issue of whether an organization had standing to seek a declaratory judgment regarding an adverse determination issued by the Service. Another organization, the Life Science Church (Chapter 669) of San Diego, California, had submitted an application for exempt status under IRC 501(c)(3), stating that its charter was granted to it by its parent church, the Life Science Church, which is a division of the Basic Bible Church in Minneapolis, Minnesota. The Life Science Church (Chapter 669) then mailed the Service a letter stating that

it would like to change its name to "The New Covenant Church in America;" that this church had absolutely no affiliation with the Basic Bible Church of Minneapolis, Minnesota; and that it was a completely separate and independent church. No charter or application Form 1023 was submitted for the New Covenant Church in America.

A proposed adverse ruling letter was subsequently issued to the Life Science Church (Chapter 669) for failure to provide requested information. In this letter, the Service also advised Life Science Church (Chapter 669) that the New Covenant Church in America was a separate entity and would have to file its own application Form 1023 to obtain Service recognition of its exempt status.

In response to this letter, a copy of articles of incorporation of the New Covenant Church in America, along with other information regarding this entity (including a name change to "American New Covenant Church") was submitted to the Service. No application or supporting documentation was ever submitted to the Service to seek a determination that the entity entitled American New Covenant Church qualified as an IRC 501(C)(3) organization.

The Service did not consider the materials received from American New Covenant Church as support for Life Science Church (Chapter 669)'s application for exempt status, and issued a final adverse ruling to the latter organization. Thereafter, the American New Covenant Church filed a petition for declaratory judgment contesting the Service's final adverse ruling issued to Life Science Church (Chapter 669).

IRC 7428(b) provides certain limitations on the Tax Court's jurisdiction for declaratory judgments relating to IRC 501(c)(3) status. Under IRC 7428(b), the Tax Court's jurisdiction is limited to actions filed by the organization the qualification of which is at issue and only after it has exhausted its administrative remedies.

The Tax Court therefore had to address the issue of whether Life Science Church (Chapter 669) had undergone a mere name change or whether American New Covenant Church was a separate and distinct legal entity. The court concluded, based on the facts discussed above, that L.S.C. (chapter 669) and the American New Covenant Church were two separate legal entities, and that the Service was entirely justified in insisting that the new organization submit a new application for exemption. Because the American New Covenant Church was a separate legal entity, it had no standing to seek a declaratory judgment on the tax

exempt status of L.S.C. (Chapter 669), the organization which received the adverse determination. The court also concluded that it did not have jurisdiction to make a declaration on the tax exempt status of the American New Covenant Church because that organization had never submitted an application for exemption and therefore had failed to exhaust its administrative remedies.

4. Nonexempt Activities

An organization is not exempt under section 501(c)(3) if more than an insubstantial part of its activities is not in furtherance of an exempt purpose. This rule was applied by the Tax Court in First Libertarian Church v. Commissioner, 74 T.C. 27 (5-27-80), which held that an organization did not qualify for exempt status under IRC 501(c)(3) because its sponsorship of social/political meetings and a newsletter were substantial activities that were not in furtherance of an exempt purpose.

The First Libertarian Church (FLC) was founded in 1975 as an outgrowth of the Libertarian Supper Club of Los Angeles (Club) to further the doctrine of "ethical egoism" or "voluntarism." The club was established in 1972 by a group of college students to conduct regular meetings at which a meal was served and various ethical and political topics were discussed. FLC was formed by members of the Club as an outgrowth of these meetings and claimed exemption as a religious organization. After its formation, FLC (1) conducted church meetings just before Club meetings, (2) sponsored the support, (3) conducted club meetings, and (4) published the Club-Church newsletter. FLC also sponsored a libertarian arbitration service and a civil liberties council. FLC conducted at least three arbitrations and its civil liberties council, although inactive, was formed to submit amicus curiae briefs and offer legal aid and assistance in selected cases where property rights were threatened by state action.

The Tax Court concluded that FLC had failed to show that its activities and purposes were not social/political to more than an insubstantial degree, and that it failed to show that it has successfully segregated out the clearly social and political aspects from the portions of the meetings designed solely to further its doctrine of ethical egoism. Therefore, the court held, FLC did not qualify for exemption under IRC 501(c)(3).

5. Burden of Proof

To qualify for exemption under IRC 501(c)(3), an organization has the burden of showing (1) that it is organized and operated exclusively for religious or charitable purposes, (2) that no part of its earnings inure to the benefit of a private individual or shareholder, and (3) that it does not engage in political activity and no substantial part of its activities consists of the dissemination of propaganda or otherwise attempting to influence legislation. In other words, the organization applying for exemption has the burden of proof to show that it satisfies the requirements for exemption.

This principle was applied by the Tax Court in Bubbling Well Church of Universal Love, Inc. v. Commissioner, 74 T.C. 39 (6-9-80), in holding that an organization claiming to be a church did not meet its burden of proof. The court attached significance to the fact that the organization was controlled by members of one family, which was not subject to any outside control from any denomination or ecclesiastical body. The court noted that while this type of control did not necessarily disqualify the organization for exemption, it provided an obvious opportunity for abuse of tax exempt status.

The court further stated that "such an arrangement calls for open and candid disclosure of all facts bearing upon the organization's organization, operations, and finances so that the Court, should it uphold the claimed exemption, can be assured that it is not sanctioning an abuse of the revenue laws. If such disclosure is not made, the logical inference is that the facts, if disclosed, would show that petitioner fails to meet the requirements of section 501(c)(3)." Specifically, the court was not convinced from the information in the administrative file that part of the net earnings did not inure to the benefit of the controlling family. Most of the organization's income was expended for the benefit of the founder's family; no funds were budgeted or expended for any kind of evangelistic program or for the care of the sick or needy. Also, the organization furnished no information to show that compensation paid to the family members was reasonable in amount, and there was no information indicating any regular pattern of worship services or meetings.

6. Summons Enforcement

In United States v. La Salle National Bank [78-2 USTC 9501], 437 U.S. 298 (1978), the Supreme Court held that in order to enforce an IRS summons in district court the summons must be issued prior to a recommendation by the Service for criminal prosecution relative to the subject matter of the summons. Also, the Service must use its summons authority in good faith pursuit of the purposes of IRC 7602. The good faith of the Service in issuing a summons is tested by the four

criteria set out in United States v. Powell [64-2 USTC 9858], 379 U.S. 48(1964): the Service must show (1) that the investigation will be conducted pursuant to a legitimate purpose; (2) that the inquiry may be relevant to the purpose; (3) that the information sought is not already in the possession of the Service; and (4) that the administrative steps required by the Internal Revenue Code have been followed. Summonses issued pursuant to an examination of a church are further limited by IRC 7605(c) and Reg. 301.7605-1(c). See, generally, IRM 7(10)71, Specialized Examinations - Churches or a Convention or Association of Churches.

Two recent court cases discussed the second Powell requirement, which is the relevancy requirement, in determining whether a summons issued to a church was enforceable. These cases reached opposite results on the issue of whether the summoned material was relevant to a proper Service inquiry.

In U.S. v. Holmes, 80-1 U.S.T.C. 9328 (5th Cir. 1980), the Service issued a summons directing Holmes, as bishop and director of the Miletus Church, to produce the following documents pursuant to the Service's examination of the status of the Miletus Church as an exempt organization under IRC 501(c)(3) and as an IRC 170(b)(1)(A)(i) church:

1. All records pertaining to cash receipts and disbursements, including but not limited to bank accounts, deposit slips, cancelled checks, records of contributions to The Miletus Church, Inc., records of contributions by The Miletus Church, Inc., sales of merchandise, payroll records, and records related to payment of employment or social security taxes, for the period beginning April 9, 1975 through the year ended December 31, 1977.

2. All balance sheets and other statements of financial condition covering the period from April 9, 1975 through the year ended December 31, 1977, including but not limited to those showing the assets and liabilities of The Miletus Church, Inc.

3. All documents related to the organizational structure of The Miletus Church, Inc. since the original Articles of Incorporation, charter, by-laws were issued, including any amendments made thereto.

4. All correspondence files for the period April 9, 1975 through the year ended December 31, 1977.

5. All records of the names and addresses of persons who are or have been officers, directors, trustees, or ministers of The Miletus Church, Inc. at any time during the period April 9, 1975 through December 31, 1977.

6. All minutes of any meetings held by the above officers, directors, trustees, or ministers of the Miletus Church, Inc. during the period April 9, 1975 through the year ended December 31, 1977.

7. One sample of each brochure, pamphlet handout, program or other literature pertaining to The Miletus Church, Inc.

8. All records reflecting the names of any employees, associates or ministers of The Miletus Church, Inc., particularly any records reflecting the names of the individuals who have been presented credentials of ministry, certificates of ordination, diplomas, or similar statements of recognition by The Miletus Church, Inc.

9. All records reflecting the names of any other organizations that have been chartered as churches or integrated auxiliaries by The Miletus Church, Inc. or that have been affiliated with The Miletus Church, Inc. at any time during the period April 9, 1975 through the year ended December 31, 1977.

10. Documents reflecting any sacerdotal functions performed by any person representing The Miletus Church, Inc.

11. All documents reflecting the principles, creeds, precepts, doctrines, practices, and disciplines espoused by The Miletus Church, Inc.

12. All documents reflecting any prerequisites or actions necessary for membership in an ordination by The Miletus Church, Inc.

13. All documents reflecting any vows of poverty that have been submitted to The Miletus Church, Inc. by any person during the period April 9, 1975 through the year ended December 31, 1977.

14. All documents reflecting any assignment of income to The Miletus Church, Inc., by any person during the period April 9, 1975 through the year ended December 31, 1977.

The court found that the IRS had complied with some aspects of the Powell good faith test. (The investigation was conducted in pursuit of a legitimate purpose (that is, to determine whether the church was entitled to tax exempt status under IRC 501(c)(3), whether it had unrelated business income, and whether it was an organization described in IRC 170(b)(1)(A)(i)), the church did not suggest that the government possessed the requested information, and the district court had found that the Service had complied with all the relevant procedures.) However, the court concluded that the summons was too far-reaching, and thus failed to meet the Powell relevancy requirement.

The court noted that IRC 7605(c) restricts the Powell relevancy requirement by further limiting the examination of religious activities and books of account of churches. The court concluded that the fact that the summons requested all documents relating to the organizational structure of the church since its inception; all correspondence files for the period April of 1975 and January of 1978; the minutes of all meetings of the officers, directors, trustees or ministers, during this same interval; and a sample of every piece of literature pertaining to the church amply demonstrated that the summons was too broad and therefore unenforceable. (The court disposed of the church's First Amendment argument by stating that the government's interest in maintaining the integrity of its policies is sufficiently compelling to justify any incidental infringement of the church's First Amendment rights.)

The opposite result was reached in U.S. v. The Freedom Church, 80-1 USTC 9132 (1st Cir. 1979), which upheld the validity of a far-reaching summons to the pastor of a church to determine the tax exempt status of the church. The summons requested the following information.

All books, records, and papers of The Freedom Church including but not limited to Organizational documents and by-laws; books of account, bank records, bank statements, including cancelled checks, and records of receipts and disbursements with information indicating the source and nature of such receipts and purposes for the disbursements. All corresponding files, data and lists of substantial contributors to the church and records relating to any and all assets owned or used by the Freedom Church and the manner in which such

assets were acquired. Records regarding the nature and specific extent of all religious activities conducted by the Church to include but not limited to a list of all members of the congregation and members of the Sacerdotal Order of the Freedom Church and the manner by which such members are selected. Records to indicate which members, if any, have taken a vow of poverty with records of all, if any, of the assets or income turned over or to be turned over to the church. All records and information on the specific activities conducted by such members to the extent that such activities are attributed to the religious purpose or creed of the church. Correspondence files which will explain the relationship, if any, between the Freedom Church, The Council of Free Churches, Life Science Church and Bishop William E. Drexler, D.D. All records and information concerning any contracts and agreements entered into by the church with its Pastor, Reverend Doncaster. Documents and records related to the background of your ministers and trustees to include a precis of curriculum completed by the ordained ministers who are members of the church and the circumstances pertaining to their ordination.

The government subsequently moved to amend the petition to omit from the summoned material the organizational documents and by-laws, and the motion was granted.

The church argued that the summons request for membership and contributor lists constituted an infringement of the First Amendment rights of the pastor and his congregants. Also, the Powell relevancy requirement was not met in that certain requested items, particularly the membership and contributors lists, were not relevant to an investigation of tax exempt status.

The court dismissed the constitutional argument by stating that it declined to adopt a per se rule regarding Service requests for church membership lists, and further that the church had made no showing that the Service's request for such lists would have any actual or potential adverse affect on their rights of associational freedoms under the First Amendment.

The court also concluded that the church's argument that the summons did not meet the Powell relevancy requirement was similarly unsupported by the record. The court stated that "once the government has made its minimal showing of the relevancy of the information sought, the burden shifts to the summoinee [church] to challenge the summons on that or any other ground." Because the

church produced no evidence that the summoned material was irrelevant, the court found that the church had not met its burden of proof on this issue, and that there was no abuse of discretion in the lower court's finding that the summoned material was relevant.

The results in these two cases highlight the concerns in showing relevancy and the need for caution in issuing summonses in church examinations.

7. Inurement and Private Benefit

There are several recent court cases involving religious organizations where the court has held that the organization was not organized and operated exclusively for religious purposes because of private benefit or inurement of net earnings. In the typical situation, an individual sets up and control the organization, contributes most of the organization's funds (for which an IRC 170 charitable contribution deduction is claimed), and then uses these funds for his or her personal living expenses. The courts in all these cases held that the organization was not organized and operated exclusively for religious purposes, regardless of whether or not it was otherwise engaged in any significant religious activities. Synopses of these cases are listed below.

Unitary Mission Church of Long Island v. Commissioner, 74 T.C. 36 (6-3-80).

Three individuals formed a religious organization that claimed tax exempt status under IRC 501(c)(3). The organization had a religious doctrine and conducted, through its ministers, various types of religious activities. However, the court concluded that the organization was not entitled to exemption under IRC because a part of its net earnings inured to the benefit of private shareholders or individuals. One of the cofounders and ministers of the organization earned \$60,000 per year from outside employment. He contributed 74 percent or \$103,900 of the \$140,000 in contributions received by the organization for the years 1975 through 1977 as follows:

[Financial information not shown here]

The organization also expended at least \$22,000 for permanent improvements and maintenance of its "parsonage," which was the ground floor of the cofounder's house. More than \$12,000 of this

amount was spent for such permanent improvements as the construction of a fireplace, the installation of a sound system, the purchase of a piano, an organ, tables, chairs, a statue and paintings. The remaining money was spent on painting, landscaping, carpeting, furniture, lighting, and general repairs. The organization also paid travel expenses for the cofounder and his wife (also a cofounder) to various church conferences, and made two loans totaling \$7,000 to the cofounder's secular employer and one of the other ministers.

The court concluded that there were sufficient facts in the record to indicate inurement of net earnings to the cofounder and other individuals. The court noted that there was no indication in the record of why the cofounder's parsonage allowance more than doubled in 1976 and then was reduced to its lowest amount in 1977, and there was no evidence in the record that any of his duties changed during these years. Also, there was no evidence that the other two ministers performed any services for the organization. Based on these facts, the court found that at least the parsonage allowances paid to the cofounder in 1976 and all of the parsonage allowances paid to the other ministers were excessive.

The court also noted that the cofounder and his wife were two of the three members of the organization's board of directors and controlled its financial decisions. Besides controlling the determination of parsonage allowances, the cofounders controlled the decisions regarding reimbursement for their own travel expenses, the repairs and improvements to the parsonage located in their house, and the loans made to the cofounder's secular employer. Although control of financial decisions by individuals who appear to benefit personally from certain expenditures does not necessarily indicate inurement, those factors coupled with little or no factors in the administrative record to indicate the reasonableness and appropriateness of the expenses were sufficient to convince the court that there was inurement.

The Southern Church of Universal Brotherhood Assembled, Inc. v. Commissioner, 74 T.C. 89 (9-10-80)

An organization was formed to operate as a church for religious purposes. It had religious tenets and conducted various religious

activities, including meetings of members with reception, invocation, meditation, prayers, etc.

Since its incorporation, the organization had five trustee-members. The president and minister devoted 20 hours a week to church activities and 40 hours a week to outside employment. He and his family owned the residence that constituted the parsonage and the place where services were held. Virtually all of the organization's income was donated by him, and most of the expenditures were for his living expenses, such as utilities, fuel, maintenance, food, postage, etc. The court concluded that these facts indicated that the organization served the private interests of its minister, and therefore did not qualify for exemption under IRC 501(c)(3).

Basic Bible Church v. Commissioner, 74 T.C. 62 (7-28-80)

A married couple and their daughter set up an organization to operate as a subsidiary or auxiliary church of the Basic Bible Church of America, Minneapolis, Minnesota, which had been recognized as exempt under IRC 501(c)(3). They were the organization's ministers, and took vows of poverty and assigned their income and various other properties, including furniture, an automobile, and riding and recreational equipment, to the organization. This assignment was conditioned on, among other things, the organization's receipt of tax exempt status. The organization received most of its funds from these individuals. \$24,000 of the \$32,000 of the organization's expenditures were for the minister's subsistence allowance. The organization also incurred the following liabilities:

Automobile loan	\$ 6,493.49
Fuel, gravel for driveway and parking area, and parsonage items	<u>3,500.00</u>
	\$ 9,993.49

The organization conducted regular religious services at the Founding couple's home. The congregation consisted of from three to twelve members, excluding the founders. The organization also stated

in its exemption applications that it engaged in various charitable/religious activities, such as transporting the elderly, feeding the hungry, etc. although there was no documentation to support these statements.

The court concluded that the organization served the private interests of its founder and his family. The court noted that the founder had total control over the management of the organization's affairs and determined how its money was spent. He held title to all property, both real and personal, in his own name. Also, the organization listed as its liabilities an automobile loan of \$6,493.49 and debts for fuel for the founder's residence and other items. Finally, the court noted that most of the organization's funds were expended for the founder's benefit. The court concluded that, despite its also serving religious and charitable purposes, the organization existed to a great extent to serve the private benefit of the founder.

People of God Community v. Commissioner, 75 T.C. 8 (10-14-80)

An organization that operated as a Christian church applied for exemption under IRC 501(c)(3). The organization had 150 members that met together regularly for religious services. The organization also performed baptisms, marriages, and funerals. There were three ministers who also comprised the board of directors. One of the ministers was the founder of the organization.

The court held that the organization was not exempt under IRC 501(c)(3) because a part of its net earnings inured to the benefit of its ministers. The founder-minister's compensation was based on a percentage of the gross tithes and offerings received. The percentage was based on what the founder received in the prior year, adjusted upward to reflect his increased personal expenses such as "home improvements and rapidly rising taxes" and downward to the extent that larger gross receipts permitted an increase in the compensation of the organization's other ministers, who also received a percentage of gross tithes. A pre-determined part of the founder's compensation was designated as "housing allowance," which he applied toward the purchase of a home. Total ministers' salaries made up of 86 percent of the organization's 1978 budget and 69 percent of the 1977 budget.

The court concluded that the organization had the burden of proof to establish the reasonableness of the ministers' compensation. The organization failed to carry this burden inasmuch as the record on this point contained little more than conclusory assertions and the fact that the founder's compensation was partly based on his personal needs. The court also found that the percentage compensation arrangement showed clearly that a part of the organization's net earnings was paid to private shareholders or individuals. Although contingent compensation arrangements do not per se preclude tax exempt status, exempt status will be denied where the founders or controlling members have a personal stake in the organization's receipts.

In addition to these cases, there are several tax court memorandum decisions involving the issue of whether IRC 170 deductions were allowable for contributions to purported religious organizations. These cases all held that the deduction was not allowable on the basis that the purported church was not organized and operated exclusively for religious purposes because of inurement or private benefit. See Manson v. Commissioner, T.C.M. 1980-315 (organization served primarily as the minister's "incorporated (religious) pocketbook" to give colorable justification to his attempt to insulate a substantial portion of his salesman's earnings from taxation); Abney v. Commissioner, T.C.M. 1980-27 (evidence did not show that the organization had any functions other than to hold title to the founder's automobile and the bank account used to pay the founder's expenses); and Pusch v. Commissioner, T.C.M. 1980-4 (founder had complete control over the organization's bank account, and testified that he and the organization had "no real separate financial identities"). Earlier tax court memorandum decisions disallowing a charitable deduction because of inurement/private benefit on the part of the recipient-church include Clippinger v. Commissioner, T.C.M. 1978-107, and Heller v. Commissioner, T.C.M. 1978-149.

8. Recent Manual Provisions

MT 7(10)00-75 was issued on November 21, 1980, transmitting text for new IRM 7(10)71.5, Denial and Revocation of Recognition of Church Status. New IRM 7(10)71.5 sets forth the procedures for denying recognition of exemption of a

church that has not applied for recognition of exemption and for revoking the continuing recognition of exemption of a church where, in either instance, the organization fails to produce its books of account after exhaustion of the preexamination procedures under IRC 7605(c). The adverse action will be based on the organization's failure to establish that it is described in IRC 501(c)(3). This procedure may be used in lieu of issuing and enforcing a summons for church books of account, subject to certain limitations. New IRM 7(10)71.5 appears below.

7(10)71.51

Denial and Revocation of Recognition of Church Status

7(10)71.51

Introduction

(1) This chapter sets forth the instructions for determining the tax exempt status of a church that has not applied for recognition of exemption and for revoking the continuing exempt status of a church having a ruling or determination letter where, in each instance, the organization fails to produce its books of account after exhaustion of the preexamination procedures under IRC 7605(c). Each adverse action will be based on the organization's failure to establish that it is described in IRC 501(c)(3).

(2) IRC 508(a) provides that an organization organized after October 9, 1969, shall not be treated as an organization described in section 501(c)(3) unless it gives notice to the Secretary that it is applying for recognition of such status. IRC 508(c)(1)(A) specifically excepts churches from this notice requirement.

(3) Treas. Reg. 1.508-1(a)(4) states that any organization excepted from the requirement of filing notice under IRC 508(a) will be exempt from taxation under IRC 501(c)(3) if it meets the requirements of that section, whether or not it files such notice. However, the IRS will not issue a ruling or determination letter recognizing the organization's exempt status unless the excepted organization files proof of its exemption in the manner prescribed in Treas. Reg. 1.501(a)-1.

(4) An organization that is a church, an integrated auxiliary of a church or a convention or association of churches is excepted from the annual return filing requirements by IRC 6033(a)(2).

(5) Treas. Reg. 1.6033-2(h)(2) provides in part, that every organization that is exempt from tax, whether or not it is required to file an annual information return, shall submit such additional information as may be required by the Internal Revenue Service for the purpose of inquiring into its exempt status and administering the provisions of IRC 501 and the subsequent Code sections.

(6) The preexamination procedures for churches found in IRM 7(10)71.3 are designed to effect the basic purpose of securing more information from organizations on a more current basis, with the goal of assuring that the Service would have sufficient information to make an initial or continuing determination of exempt status.

(a) In the case of a church that has a ruling or determination letter recognizing it as tax exempt and that fails to produce books of account after exhaustion of the preexamination procedures under IRC 7605(c), the sanction of revocation of recognition of exempt status is permissible. In this manner, the Service withdraws its formal recognition of exemption for a taxable year or years.

(b) In the case of a church that does not have a ruling or determination letter recognizing it as exempt and that fails to produce books of account after exhaustion of the the preexamination procedures under IRC 7605(c), the sanction of denial of recognition of exempt status is permissible. In this manner, the Service does not grant formal recognition of exemption. This action may be taken without the church first filing for proof of exemption as prescribed in Treas. Reg. 1.501(a)-1.

(7) The instructions and procedures described in IRM 7(10)71.52 may be used in lieu of issuing and enforcing a summons for church books of account, subject to the limitations stated therein. This procedure may be useful in certain situations, essentially where the Service has no need to proceed to summons enforcement to resolve such questions as the deductibility of contributions, the assessment of employment taxes or the use of the church to reduce income tax liability. The facts and circumstances of each case will determine if this procedure is appropriate.

7(10)71.52

Instructions and Procedures

(1) The key districts will follow the preexamination procedures in IRM 7(10)71.3. The preexamination procedure includes issuing the Regional Commissioner's letter approving the examination of the organization's books of account.

(a) Generally, the Service may request any information relevant to the proper areas of Service inquiry. The information requested should be limited to that which the organization can reasonably compile and assemble and which is necessary to resolve the area or areas of inquiry. The requested information must be material to the initial or continuing determination of exempt status.

(b) To ensure that the information requested is relevant to the proper areas of Service inquiry, the preexamination letters should consist of the questions, as appropriate, using Exhibit 7(10)70-2 as a guide. Preexamination letters containing questions that deviate substantially from those in the exhibit should be submitted for consideration to District Counsel.

(2) The organization must be given adequate opportunity to produce the information before proposing to deny or revoke recognition of exempt status. In preparing this preexamination letter, the period of time permitted for response should represent a reasonable amount of time for the organization to gather and furnish the information requested. This period will generally not be less than 15 days, subject to variance on a case-by-case basis. In determining what a reasonable response time will be, examiners should give consideration to the size of the organization, the type of records requested, and the amount of information the organization is being asked to provide.

(3) All preexamination letters and the Regional Commissioner's letter approving the examination must advise the organization of the consequences of the organization's refusal to provide the information. See Exhibit 7(10)70-1 for Pattern Letter P-645, Preexamination Cover Letter, and Exhibit 7(10)70-3 for Pattern Letter P-598, Regional Commissioner's Approval of Church Examination Letter.

(4) The sanctions of denial and revocation of recognition of exempt status with respect to churches will be used sparingly. It is critically important that the administrative record support the reasonableness of the Service's action in these cases. Therefore, the key districts will forward all case files and proposed adverse letters on churches to the Office of the ARC (Examination) for review prior to issuing the proposed revocation or denial letter. Upon concurrence from the region,

the case file will be returned to the key district for issuance of the proposed revocation or denial letter.

(5) The grounds set forth in the proposed and final determination letters are to be limited to an explanation that the organization has not provided the information requested after repeated requests and, as forewarned, the organization will have failed to establish that it is described in section 501(c)(3). The following statement, Pattern Letter 1426 (P)(10-80), will be used in these letters: "Even though we have sent you several requests for the required information, we have not received the necessary information to support the claim that your organization is described in section 501(c)(3) of the Internal Revenue Code. As a result, we find that you have not established that your organization is of the kind described in Code section 501(c)(3)."

7(10)71.6

Referrals to State Attorneys
General

In accordance with the procedures outlined in IRC 6104(c) and Treas. Reg. 301.6104-3, the appropriate state officials, including a state Attorney General, should be notified of any final decision that an organization which claims to be a church is not entitled to initial or continuing qualification as an organization described in IRC 501(c)(3).