

C. UPDATE ON CHURCHES AND RELIGION

1. Introduction

Americans remain a very religious people. A recent commentator* provides some very interesting statistics:

Sixty-one percent (132,000,000) of the U.S. population is actively affiliated with the 1275 "primary" religious groups in the country. Those religious groups received nearly half (\$18.4 billion, 47 percent) of the direct charitable contributions (\$39.6 billion) made in 1978. And, these figures do not reflect endowment and interest income, earned income, or grants made to "church-related" institutions like schools, hospitals, homes for the aged, etc. Indeed, religious activities are significant in American lives and purses.

Since churches and religious organizations are such a significant part of the tax exempt community, we have discussed them in previous EOATRIs. This topic contains three parts:

The first part recaps the extensive, but extremely delicate, role the Service has in evaluating the tax status of churches and religious organizations. Naturally we (EO) focus on the exemption and charitable contributions questions, even though these questions are bound up with the larger, related issues of tax avoidance, illegality, and Constitutional limitations on Service (government) regulation. (The 1978 and 1979 EOATRI topics on churches and religious organizations provide good background.)

The second part updates the cases and published precedent in the area since the last EOATRI.

The third part identifies and discusses new Manual provisions affecting EO handling of churches and religious organizations.

*Carl Bakal, *Charity USA -- An Investigation into the Hidden World of the Multi-billion Dollar Charity Industry*, Times Books (1979), pp. 85-87. Mr. Bakal's data comes from sources like the Filer Commission, the National Council of Churches, and the American Association of Fund-Raising Counsel.

2. Service Role

Critics differ over whether the Service treats churches and religious organizations properly. Some argue that the Service over-regulates these organizations to the point of infringing their First Amendment right to exercise their religious beliefs freely, while other critics think that Service enforcement of the Code is too lax to prevent unscrupulous parties from using religion as a shield to hide illegal activities or other selfish endeavors. Interestingly, critics of all religious persuasions can be found on both sides of the argument.

The proper Service role, of course, is neutral and impartial enforcement of the applicable IRC provisions. The First Amendment to the Constitution mandates governmental neutrality, and courts evaluating government treatment of churches and religious organizations hold the Service strictly to that standard. Walz v. Tax Commissioner, 397 U.S. 664 (1970); Committee for Public Education v. Nyquist, 413 U.S. 756 (1973). The Service's announced policy has always been Constitutionally-mandated "benevolent neutrality."

A recent decision reinforces the propriety of the neutral enforcement standard. In General Conference of the Free Church of America v. Commissioner of the Internal Revenue, 71 T.C. 920 (1979), the court held that the Service was administering the Code in a Constitutionally proper fashion when it sought from the organization the information necessary to demonstrate compliance with the exemption requirements of IRC 501(c)(3). The court stated:

In the instant case we believe that the administrative record clearly shows that respondent acted in an impartial, unbiased, and non-discriminatory manner in his refusal of petitioner's requested tax exemption. Respondent's inquiries were pertinent to determining petitioner's status as a religious organization. No illegal discrimination in the refusal to grant the exemption has been demonstrated by petitioner, nor has it shown that the refusal was in any manner based upon a judgment of its religious tenets. Indeed, the only determination made by respondent was that petitioner failed to supply the requisite information upon which an exemption might be granted.

Probably the clearest restatement of the Service role was Commissioner Kurtz' speech before the PLI Seventh Biennial Conference on Tax Planning for Foundations, Tax Exempt Status, and Charitable Contributions, in New York City on January 9, 1978. It was published as IR-1930. It summarized the Service role:

All of government--including the IRS--is constrained in the largest context by the First Amendment's Free Exercise and Establishment Clauses. In the Supreme Court's words, religious exercise must be permitted "to exist without sponsorship and without interference." (Walz v. Tax Commissioner, 397 U.S. 664, 669 (1970)). Exemption of religious institutions, whether from property or income taxes, has been characterized by the court as representative of a "benevolent neutrality towards churches and religious exercise generally" that is "deeply imbedded in the fabric of our national life." (Id. at 676-77.) In addition to the constraint implicit in neutrality, government must ensure as well that the effect of otherwise appropriate decisions does not result in an "excessive entanglement" with religion.

The most fundamental perception we have of our role then is to administer these provisions with unimpeachable neutrality, using as our premise Justice Douglas' eloquent phrase that this society will "make room for as wide a variety of beliefs and creeds as the spiritual needs of man deem necessary." (Zorach v. Clausen, 343 U.S. 306, 313-14 (1952).)

Having said that, however, does not mean that these First Amendment rights are absolutes or can be asserted as a screen for any kind of conduct. While the court has found within the religious clauses of the First Amendment both a freedom to believe and a freedom to act, it has also found that the former is absolute while the latter is not. (Reynolds v. U.S., 98 U.S. 145 (1978).)

The Service, of course, has no concern with an individual's privately held beliefs, but it cannot always avoid [with](sic) actions based on such beliefs. When a group makes its beliefs and programs a basis for seeking preferential tax treatment, then the Service has an obligation to inquire whether such preferences should appropriately be extended to such group.

There are two basic inquiries in determining whether a church or religious organization is described in IRC 501(c)(3) and therefore qualifies for IRC 501(a) exemption and related benefits:

(1) Are the organization's beliefs and tenets sincerely held?

(2) In practicing its beliefs, does the organization meet all the requirements for IRC 501(a) exemption set out in IRC 501(c)(3)?

The Service has the right and the duty to inquire into the sincerity of the beliefs professed by a church or religious organization seeking preferred tax treatment--exemption under IRC 501(c)(3). While the Constitution protects our citizenry from arbitrary governmental judgments on the legitimacy or correctness of religious beliefs, United States v. Seeger, 380 U.S. 163 (1965), Fowler v Rhode Island, 345 U.S. 67 (1953), the Constitution does not condone a taxpayer's subversion of the law through the guise of religious belief. Only sincerely held religious beliefs are entitled to the protection of the First Amendment to the Constitution. U.S. v Ballard, 322 U.S. 78 (1943).

The inquiry into sincerity of belief must be very narrow and may not go to legitimacy or validity of belief. For example, a religious organization may profess a belief that the use of an illegal narcotic is a required religious ritual. The Service would be precluded from passing on the legitimacy or validity of the religious belief, but would not be prohibited from questioning the sincerity of the belief. For instance, if evidence indicated that the founder or members formed the organization to avoid the drug laws, the Service could properly question the sincerity of the religious belief. In addition, such evidence would probably support a finding that the organization was operating contrary to public policy and therefore not for exempt charitable purposes.* See United States v. Kuch, 288 F. Supp. 439 (D.D.C. 1968), where the court held that membership in a church, espousing the use of marijuana and LSD, could not shield church members from civil society's drug laws.

*Rev. Rul. 75-231, 1975-1 C.B. 158. In discussing Situation 3, where a church-related school denied admission to students on the basis of race because it claimed that its religious tenets dictated the racial discrimination, the Rev. Rul. held that the school could not be recognized as exempt under IRC 501(c)(3). The Rev. Rul. stated, "It is well settled that a religious basis for an activity will not serve to preclude governmental interference with that activity if it is otherwise clearly contrary to Federal public policy."

The Service has seldom cited the sincerity requirement in denying tax exemption for two reasons. First, sincerity is so subjective that courts are often reluctant, except in the clearest cases, to favor an administrative agency's determination on the question over a religious claimant's word. Second, because insincerely held religious beliefs usually screen other nonexempt activities (like inurement or private gain), the Service can base denial of exemption on the usual IRC 501(c)(3) requirements without invoking the difficult-to-prove insincerity basis.

Therefore, our most tangible and important inquiry is whether the organization seeking exemption meets all the IRC 501(c)(3) requirements. In the case of a church or religious organization seeking IRC 501(c)(3) exemption, the organization would have to satisfy the following:

- (1) It is organized and operated exclusively for charitable, "religious" purposes within the meaning of IRC 501(c)(3) and the regulations.
- (2) It must refrain from political action (Reg. 1.501(c)(3)-1(c)(3)(iii)).
- (3) It may not engage in substantial amounts of legislative action (Reg. 1.501(c)(3)-1(c)(3)(ii) and (iv)).
- (4) It may not operate so that its earnings inure to the benefit of private individuals or shareholders.
- (5) It may not engage in illegal activity or activity contrary to public policy (Rev. Rul. 71-447, 1971-2 C.B. 230).

All of these requirements are crucial to IRC 501(c)(3) exemption. The 1978 EOATRI (pp. 1-29) and the 1979 EOATRI (pp. 165-183) discussed these requirements, as well as the problems the Service has in obtaining information to determine whether an organization meets these requirements: Remember that churches described in IRC 170(b)(1)(A)(i) are not subject to the IRC 508 notice requirements, do not have to file information returns under IRC 6033, have the benefit of the IRC 7605 pre-examination rules, and are covered by judicially-patrolled Constitutional safeguards against excessive government regulation.

3. Update of Cases and Published Precedent

These are some of the more significant cases and precedents since last year's EOATRI. They cover the period roughly from January 1, 1979, to December 31, 1979.

a. Rev. Rul. 79-359

Religious activities are as varied as the diverse religious groups and churches. Often religious beliefs affect everyday activities. For example, religious tenets may restrict diet, prohibit work at various times, supersede secular standards of education (Pierce v. Society of Sisters, 268 U.S. 510 (1925)), or require a lifestyle largely different from the majority's (Wisconsin v. Yoder, 406 U.S. 205 (1972)). Religious beliefs almost always color major life-cycle events -- birth, death, marriage, coming-of-age, etc.

Rev. Rul. 79-359, 1979-45 I.R.B. 10, gives an example of an organization performing an otherwise secular activity in a manner required by certain religious beliefs. The Rev. Rul. holds that an organization, otherwise qualified for IRC 501(c)(3) exemption, whose purpose is to provide traditional burial services that directly support and maintain basic tenets and beliefs of a religion regarding burial of its members is operated exclusively for charitable (religious) purposes and is exempt under IRC 501(c)(3).

b. Cases

(1) Obtaining Information from Churches

In Bronner v. Commissioner, 72 T.C. 368 (1979), the tax court considered the legitimacy of a Service summons for information. The individual taxpayer had formed the All One Faith In One God State Universal Life Church, Inc. and mingled the church's assets with his own business assets and property. The Church claimed exemption but had never applied to the Service for a determination. The Service requested information from the taxpayer, in his individual capacity and in his capacity as head of the church, to determine whether the taxpayer had operated the church as a vehicle to carry on his own business and avoid tax. The records requested were the church's membership lists and bank statements, and the individual taxpayer's financial records. The taxpayer refused to respond on the ground that Service inquiries would interfere with his First Amendment rights to free exercise of religion and to freedom of association (privacy). The court held that the Service request for information was relevant to the tax determination, was

a proper and impartial governmental attempt to administer the tax laws, and therefore did not violate the taxpayer's Constitutional rights.

We have already mentioned General Conference of the Free Church of America v. Commissioner, 71 T.C. 920 (1979), in this topic. That case supports the right of the Service to inquire into the merits of a church's or a religious organization's operation, when such an organization seeks exemption and represents that it is entitled to that preferred tax status. The Service's mission to assure compliance with the tax laws obligates it to make the inquiry.

An interesting District Court case addressed the refusal of an individual taxpayer and his church to comply with a Service summons for documents and testimony. United States of America and John De Zelar, Revenue Agent of the Internal Revenue Service, Petitioners v. Lyle Miller, as Director and Trustee of the Basic Bible Church of America, and the Basic Bible Church of America, Respondents, U.S.D.C., District of Minnesota, Fourth Division, 79-2 U.S.T.C. 9467, 44 AFTR 79-5262 (June 11, 1979). The court ruled that the taxpayer was not in contempt of court for his earlier refusals to obey the summons, because his refusal was based on the belief that pending judicial appeals excused him. However, the court reordered the taxpayer to respond to the summons. The court found that a proper examination of the summoned documents (church's and taxpayer's) and testimony must occur in order for the Service to determine the tax liability of both the individual taxpayer and his church. The court was not swayed by the taxpayer's contention that responding to the Service inquiries would interfere with his Constitutionally protected religious freedom.

Two other recent summons cases reach a similar result. See U.S. v. Toy National Bank, 79-1 U.S.T.C. 9344, 43 AFTR2d 79-954 (2/27/79), and U.S. v. Pusch, 79-2 U.S.T.C. 9663, 44 AFTR2d 79-5891 (10/17/79), both described in the Current Developments Topic. These cases reaffirm the Service's right to seek from organizations claiming exemption under IRC 501(c)(3) as churches or religious organizations the information necessary to ascertain tax status.

(2) Church Status as a Shield for Personal Tax Liability

Ownership is always a difficult determination. The facts and circumstances of each case are crucial. A recent District Court case decided whether assets the Service sought to seize to satisfy an individual taxpayer's tax liability were owned by that taxpayer or by his church. Church of Hakeem v. United States of America, U.S.D.C., Northern District of California, 79-2 U.S.T.C. 9651, 44 AFTR 79-5834

(August 31, 1979). The church claimed ownership of an account that the Service claimed belonged to the individual taxpayer; and the taxpayer had often mingled his funds with church funds. The Court found that some of the account funds in question were in the name of the individual taxpayer and were subject to seizure by the Service. It seems that, at least in the clear case of registered or titled property, a taxpayer cannot protect his own property from seizure to satisfy personal tax liability by claiming (without evidence) that the property belongs to a church.

(3) Exemption -- The Merits

In Western Catholic Church v. Commissioner, 73 T.C. 19 (10/31/79), the tax court considered a Service revocation of an alleged church. The Service concluded that the church did not meet the operational test of Reg. 1.501(c)(3)-1(c) because its primary activity was investing. The Church also sponsored some one-to-one ministry conducted by the founder and made grants to needy individuals chosen by the founder. The court agreed with the Service that the organization was not operated exclusively for exempt purposes.

In Beth-El Ministries, Inc. v. U.S., 79-2 U.S.T.C. 9412, U.S. District Court, Dist. Col. (June 6, 1979), the court held that a religious community was not exempt under IRC 501(c)(3) because its earnings inured to members. Staff members worked outside the community and donated their salaries to the community, in return for all the necessities of life -- food, clothing, shelter, medical care, recreation, schools, etc. The court found that the community was not operated exclusively for religious purposes but was operated in part for the private benefit of individual members.

In Christian Manner Int'l. Inc. v Commissioner, 71 T.C. 661 (1979), the court agreed that a religious organization was not entitled to IRC 501(c)(3) exemption. The organization's Articles of Incorporation stated that its primary purposes were religious, charitable, and educational in nature. However, its primary activity was the publication and sale of books written by the founder for a profit. This activity resulted in inurement to the founder and prevented exemption.

In contrast, another organization that sold religious literature qualified for exemption under IRC 501(c)(3). Pulpit Resource v. Commissioner, 70 T.C. 594 (1978). The sale of the literature in this case furthered an exempt (religious and educational) purpose and did not result in impermissible inurement or private benefit.

4. Recent Manual Provisions

Part VII of the Internal Revenue Manual (IRM) deals with EP/EO matters. Chapter 7(10)00 sets out Examination Procedures. Several sections of IRM 7(10)00, dealing with churches, religious organizations and related issues, have been updated in the past year. The following discussion lists the modified IRM 7(10)00 sections and describes their provisions.

IRM 7(10)20 covers summons procedures. IRM 7(10)22.2 describes the procedures for the Summons to Appear to Testify, Produce Books, etc. In general, the procedures for summons set out in IRM 4022 are followed by EP/EO. However, IRM 7(10)22.2(2) was issued on 7/23/79 to clarify that an EO specialist cannot issue a summons solely for the purpose of determining the tax liability of an individual taxpayer. This purpose is permissible and may be included in a summons issued for one or more of the remaining purposes described in regulations on IRC 7605(c).

IRM 7(10)22.3 was also issued 7/23/79. It requires that copies of summons enforcement requests on churches be sent to the National Office.

IRM 7(10)69, Exempt Organizations Examination Guidelines Handbook, has an updated Chapter 320, Examination Guidelines for Religious Organizations (9/20/79). Chapter 321 covers Churches. Chapter 321.1, General Considerations, highlights the definitional problems, notice problems under IRC 508, and filing requirements. Chapter 321.2, Preexamination Procedure, refers the specialist to the procedures set out in IRM 7(10)70, and describes when the preexamination procedures must apply to schools or other "parts" of churches. Chapter 321.3, Specific Guidelines, points out certain recurring, troublesome issues. It reemphasizes the two-pronged inquiry, sincerity of belief and legal operation in conformity with IRC 501(c)(3), we discussed at length earlier in this topic.

IRM 7(10)70, Specialized Examinations, provides guidance for certain complex examinations. IRM 7(10)71, Churches or Convention or Association of Churches, was updated 8/20/79. It discusses the methods of examining these organizations. Of special interest is the detailed explanation of the IRC 7605(c) examination restraints, the mandatory pre-examination procedures under Reg. 301.7605-1(c)(2), and the procedures for obtaining Regional Commissioner approval of the examination.

IRM 7(10)75, Certain Organizations Claiming Tax Exempt Church Status, was issued 8/20/79. This chapter deals extensively with bona fide church operation, tax avoidance schemes, tax protests, assignment of income, deductibility of contributions, and referral and coordination with the Examination Division. IRM 7(10)75 replaces MS 7(10)G-37, Examination of Certain Organizations Claiming Tax Exempt Church Status and Related Individual Returns, which appeared on pages 175-183 of the 1979 EOATRI; it also replaces IRM CR 7(10)G-36, Examination and Investigation of Illegal Tax Protest-type Activities. IRM 7(10)75 appears below.

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7(10)72 (1-12-79)
Church-Related Schools

(To be issued)

7(10)73 (1-12-79)
Private School Examinations

(To be issued)

7(10)74 (1-12-79)
**Prepaid Health Care Plans, and Professional Standards
Review Organizations**

7(10)74.1 (1-12-79)
General

(1) The prepaid health care delivery system basically consists of three types of organizations: the fee for service plans (Blue Cross/Blue Shield type plans); Health Maintenance Organizations; and Foundations for Medical Care.

(2) Professional Standards Review Organizations (PSRO's) were created pursuant to Public Law 92-603, and are one of the latest additions to the health care delivery system.

7(10)74.2 (1-12-79)
PROCEDURE

All examinations of prepaid health care plans should be completed without considering the issue of whether prepaid health care is a qualifying activity under IRC 501(c). Examinations of

prepaid health care plans and Professional Standards Review Organizations may be initiated for any reason appropriate under existing procedures as long as resolution of the matter, as foreseen at that time, will not involve the issue as to whether prepaid health care is a qualifying activity under IRC 501(c).

7(10)75 (8-20-79)

CERTAIN ORGANIZATIONS CLAIMING TAX EXEMPT CHURCH STATUS

7(10)75.1 (8-20-79)

INTRODUCTION

(1) A number of organizations involved in the sale of minister's credentials (mail order ministries) and church charters are offering "plans" which purport to reduce an individual's income taxes. A typical "plan" calls for an individual to become an ordained minister, form an organization that claims to be a church, and contribute 50% of his/her taxable income to it. The organization in turn furnishes him/her with a residence and certain living expenses. Another plan calls for an individual to take a "vow of poverty" and to assign his/her assets (house, car, savings account, etc.) and the income earned from his/her current employment to the organization. The assigned income is used for housing, food, clothing, etc., for the individual.

(2) The procedures contained in this section are intended to provide guidelines for EO personnel conducting examinations of organizations of this general class which claim tax-exempt "church" and "religious order" status.

7(10)75.2 (8-20-79)

IDENTIFICATION OF "MAIL ORDER MINISTRIES" AND RELATED INDIVIDUAL RETURNS.

(1) EP/EO Divisions will receive information reports and requests for concurrent examinations from other Service functions which identify suspected mail order ministries and tax abuse schemes of the general class described in this section. Some of these referrals will involve organizations related to or affiliated with individuals identified under the Illegal Tax Protester Program, and should be handled in accordance with the additional procedures outlined in IRM 7(10)75.6, below.

(2) EP/EO Divisions will also receive for review and possible follow-up questionable Forms SS-4 filed by alleged

churches and orders suspected of being within the general purview of this section. These will be referred by the Entity Control Section of the service centers after issuance of Employer Identification Numbers.

(3) Taxpayer assistance requests and informants' correspondence will be used to identify alleged churches and individuals involved in mail order ministries. Referrals will be made to the appropriate EP/EO Division.

(4) Various sources from outside the Service, including news articles, county records, state franchise and licensing departments, state attorneys general offices, and post offices will be used to identify alleged churches and individuals involved in mail order ministries. Referrals will be made to the appropriate EP/EO Division.

(5) During examinations conducted in connection with the tax liability of alleged churches and orders described in this section, specialists should be alert for information contained in the books of account of such entities pertaining to individual tax abuse. Any information collected should be promptly referred to the appropriate Examination Division, using Form 5666, EP/EO Information Report, with a reference to IRM 7(10)75.

(6) Specialists may examine lists containing names of purchasers of alleged church charters or individuals claiming ministerial status from alleged churches, third parties or other divisions of the Service. The list may be sought from a church in its capacity as a third-party witness. In situations where the tax liability of the alleged church is at issue, a list of the alleged church's charter purchasers may be requested in a pre-examination letter or during an examination provided that the list may be relevant to ascertaining the tax liability of the church under examination and that ascertaining the tax liability of the alleged church is a purpose for requesting the list; however, National Office authorization (E:EO:O:P) will be obtained in writing prior to seeking such a list.

(7) Any project undertaken to identify alleged churches and individuals involved in mail order ministries must be authorized in accordance with the procedures outlined in IRM 7900.

7(10)75.3 (8-20-79)

CLAIMS TO CHURCH STATUS

(1) Under IRC 508(c), churches are not required to apply for recognition of exemption with the Service in order to be treated as being described in IRC 501(c)(3). If a church meets the requirements of IRC 501(c)(3), it is automatically exempt from Federal income tax.

(2) The filing of an incomplete Form 1023 or the filing of a Form 1023, Application for Recognition of Exemption, that fails to establish an organization's exemption under IRC 501(c)(3) does not affect the organization's entitlement to claim church status and the application of IRC 7605(c) concerning restrictions on the examination of churches.

(3) An individual may claim a charitable contribution deduction to a church that has not been recognized by the Service as tax exempt. Such deduction is not barred merely because the church has never applied for recognition of exempt status. Similarly, when an organization has applied but has not provided the Service with sufficient information upon which to make a favorable determination of exempt status, a charitable deduction is not automatically barred.

7(10)75.4 (8-20-79)

COORDINATED PROCEDURES GENERALLY

7(10)75.41 (8-20-79)

COORDINATION OF IRC 170(C) DEDUCTION CASES

(1) If an IRC 170 deduction has been disallowed because the individual claiming the deduction made the contribution in the expectation of receiving benefits designed for his/her maintenance and comfort, it will generally not be necessary for the EP/EO Division to conduct a concurrent examination of the church. However, a referral using Form 5346, Examination Information Report, will be made by the Examination Division to the appropriate EP/EO Division concerning examination of the involved church or religious order. This is for information purposes only. The church will be examined only when, in the judgment of the EP/EO Division, such examination is necessary based on Service concerns. The amount of potential tax liability should not be a decisive consideration isolated from other concerns. If an examination of the church is conducted, it will not be necessary for Examination Division to suspend closing the case until the EP/EO Division has completed action on the referral. However, there should be close coordination to insure that the case is not litigated prematurely.

(2) In some instances an individual may claim that he/she is entitled to the parsonage allowance exclusion from income under IRC 107. In such cases, Examination Division will determine whether the individual has performed services that are ordinarily the duties of a minister of the gospel. If it is determined that the individual has not performed services that are ordinarily the duties of a minister of the gospel, it will not be necessary for EP/EO Division to examine the church. If it is necessary to determine whether services are performed in accordance with the tenets and practices of the church, a referral using Form 5346 will be made by Examination Division to the appropriate EP/EO Division for a concurrent examination.

(3) Where Examination Division proposes to disallow an IRC 170 deduction on the grounds that the donee organization is not described in IRC 170(c), a referral using Form 5346 will be made to the appropriate EP/EO Division. The donee organization should, if possible, be examined concurrently with the IRC 170 deduction. Cases currently in Examination or Appeals Offices that are in some state of appeal and that have not previously been coordinated with the appropriate EP/EO Division, will also be referred to EP/EO Divisions using Form 5346. EP/EO Division should immediately begin to examine these cases. Examination or Appeals offices will be suspending the closing of related cases until EP/EO Divisions have completed action on such referrals, except when closing action is required to protect the interests of the Government. Accordingly expeditious handling of such cases is required.

7(10)75.42 (8-20-79)

COORDINATION OF ASSIGNMENT OF INCOME CASES

(1) Situations may arise in which an employee claims a "vow of poverty" and either assigns part or all of his/her earnings to a church that he/she has formed through the purchase of a church charter and ministerial certificate. In such case, the individual whose principal activity is that of an employee can have his/her income determined without an examination of the church when he/she is employed by a party other than the church. Under these circumstances, Examination Division may complete the case without a concurrent examination of the church by EP/EO Division. However, EP/EO Division will be notified of the church's existence for information purposes only.

(2) An individual may claim to have assigned income, donated services, or transferred business activity to an organization claiming to be a church. If Examination Division can determine the amount of the individual's income without resort to the church's books of account, they should continue with the examination. A referral using Form 5346, Examination Information Report, will be made to the appropriate EP/EO Division concerning the involved church. This is for information purposes only. If it becomes necessary to examine the church's books of account a referral using Form 5346 will be made to the appropriate EP/EO Division for a concurrent examination. See IRM 7(10)71.21 and Exhibit 7(10)70-5 for a definition and examples of church 'books of account.'

7(10)75.43 (8-20-79)

COORDINATED SERVICE PROCEDURES

(1) Regional and District representatives from EP/EO, Examination, Criminal Investigation, Collection, and District Counsel shall meet no less than quarterly to discuss developments in the program relating to examination of alleged churches and related individuals and to discuss problems that arise.

(2) Information from Collection and Criminal Investigation Divisions concerning tax abuse schemes of the general class described in this section should be carefully screened and assigned for examination by EP/EO Division where appropriate.

7(10)75.5 (8-20-79)

PROCEDURES IN 'MAIL ORDER MINISTRIES' EXAMINATIONS

(1) The pre-examination procedures set forth in IRM 7(10)71, Churches or Convention or Association of Churches, will be followed when examining organizations of the general class described in this section (mail order ministries).

(2) Referrals on Form 5346 from Examination Divisions will be reviewed by the Chief, Technical Staff. When it is determined that examination is required, the case will be assigned and given priority consideration. Chief, EP/EO Division, will report to Chief, Examination Division, (or District Director in streamlined districts) monthly on the status of the examination.

(3) When EP/EO Division decides, after review of Form 5346, or a request for collateral examination, that an examination should not be conducted or should be terminated prior to resolution

of a related examination being conducted by another Division, the interested Division will be informed within 30 days of this decision. In the event the interested Division desires that the matter be reconsidered, the matter will be reviewed and resolved by the Division Chiefs, the District Director, the Assistant Regional Commissioners and the Regional Commissioners involved, in the order named. Every effort will be made to resolve the matter at the lowest possible level. Since a tax abuse scheme is involved, the amount of potential tax liability in controversy should not be a decisive consideration isolated from other legitimate Service concerns.

(4) When examining an organization involved in the sale of church charters and ministerial certificates, the issue of whether the organization qualifies for tax exempt status under IRC 501(c)(3) should be considered. In addition, the issue of whether the sale of these items is in furtherance of religious purposes under IRC 501(c)(3) should be raised. Examining agents should look to such issues as whether the Organization is organized and operated exclusively for exempt purposes; whether it serves private rather than public purposes; and whether its net income inures to the benefit of any private shareholders or individuals. If the issue of exempt status is considered in a case involving a tax abuse scheme, technical advice procedures should be utilized, as described in Rev. Proc. 73-8, 1973-1 C.B. 754.

(5) In order to be recognized as a religious organization described in IRC 501(c)(3), an organization must establish that it is in fact "religious"; that it is organized and operated in conformity with the basic principles of charity law; and that it does not violate any of the specific prohibitions of IRC 501(c)(3) and the regulations thereunder. An organization will be considered "religious" only if its members have a sincere and meaningful belief in whatever doctrine is espoused, and this belief occupies in the lives of those members a place parallel to that filed by God in the lives of traditionally religious persons. Under the First Amendment, the Service is precluded from considering the content or sources of a doctrine which is alleged to constitute a particular religion, and can make no attempt to evaluate the content of whatever doctrine a particular organization claims is religious. However, a mere allegation that a specific doctrine is religious is not sufficient to warrant that doctrine's designation as a religion.

(6) When examining a church of the general type described in this section, examining agents should be alert for evidence that income assigned to the church or order by an individual has been

set aside for, or used for, the benefit and enjoyment of the individual. Such evidence could indicate inurement of the organization's earnings, and would be relevant not only to the issue of exempt status under IRC 501(c)(3), but also to the deductibility of the assigned income under IRC 170 as well.

(7) Revenue Ruling 78-232, 1978-1 C.B. 69, provides that an individual who claims to be a minister, organizes a church, deposits salary checks for salary earned from outside employment in the church's bank account, and uses the funds of the account for lodging, food, clothing and other living expenses, is not entitled to a charitable deduction under IRC 170 for the amount of the salary checks. Under the circumstances described, allowance of a charitable deduction was precluded not only because the benefits which the donor reasonably expected to obtain by making the transfer were sufficiently substantial to provide a quid pro quo for it, but also because the donee "church" was not a qualified recipient under IRC 170(c)(2). The facts of the case indicated that the donee organization was operated for the private purposes of the taxpayer, rather than for exclusively exempt purposes, as required by the statute. Furthermore, since funds of the donee organization were used by or on behalf of the taxpayer, there was inurement of the type proscribed by the statute.

(8) Revenue Ruling 69-266, 1969-1 C.B. 151, similarly provides that an organization formed and operated by its creator essentially as an attempt to reduce his/her personal Federal income tax liability while still enjoying the benefits of his/her earnings, is not exempt under IRC 501(c)(3). Like the recipient church in Rev. Rul. 78-232, supra, the organization was operated for a private purpose, rather than for exclusively exempt purposes.

(9) A summons may be directed to the organization under examination or to a third party recordholder, if necessary, to obtain information from records of correspondence or financial records. All such summonses proposed to be issued by EO specialists should be submitted to District Counsel for pre-issuance review. See also IRM 7(10)71.41:(6)

7(10)75.6 (8-20-79)
ILLEGAL TAX PROTESTER PROGRAM

7(10)75.61 (8-20-79)
BACKGROUND

(1) Under the Service's Illegal Tax Protester Program, certain uniform procedures and guidelines for detecting, processing, examining and investigating illegal tax protester-type documents and activities have been established. For purposes of this program, an "illegal tax protester" is a person who employs one or more illegal schemes that affect the payment of taxes.

(2) Mail Order Ministries--For purposes of the Illegal Tax Protester Program, the "mail order ministries" illegal tax protester scheme is defined as a scheme in which an individual receives income from nonreligious sources and declares that it is nontaxable because of "vow of poverty." This scheme also involves returns where the individual includes all or substantially all of gross income as a contribution deduction on Schedule A of Form 1040. Some individuals will complete Form 1040 and then take an unusually large contribution deduction on Schedule A of Form 1040, normally 50% or more of adjusted gross income.

(3) Initial detection of illegal tax protester-type documents is made in the Processing Division area of the service center. Certain service center teams count and classify each return/document, and compile and report this information monthly under applicable procedures of the Program.

(4) Service center teams are responsible for attaching copies of a number of forms to identified returns/documents. These forms remain with the return or document until final disposition is made by the Service. At the time of final disposition, these forms are detached and returned to the service center teams.

7(10)75.62 (8-20-79)

EP/EO DIVISION PROCEDURES

(1) One of the forms attached to identified returns/documents is Form 6178-C, Illegal Tax Protester Functional Report (Exempt Organizations). The purpose of this report is to provide relevant data concerning actions taken by the EP/EO Division with respect to a subject case.

(2) In matters involving requests for examinations on referrals from Examination Division, the protest document will not typically be referred to the EP/EO Division. Accordingly, EO personnel should maintain a nominal stock of Forms 6178-C to be associated with examinations conducted under this program.

(3) In order to identify referrals as matters within the scope of this program, Examination, Collection, Criminal Investigation, and other concerned Divisions should be requested to state upon the referral that initial identification has been made under the Illegal Tax Protester Program procedures.

(4) In order to develop pertinent data relevant to the flow of work generated by illegal tax protesters, the service center team will be notified when a return or document is forwarded between functions at district offices. Upon final disposition of a return/document by the Service, the Illegal Tax Protester Functional Reports will be forwarded to the service center team.

(5) At the completion of an examination involving a matter referred to EP/EO Division under the Illegal Tax Protester Program procedures, Form 6178-C will be completed, and returned to the referring Division or appropriate Service function.

(6) Since churches, typically do not file returns other than Forms 990-T, EP/EO Division's responsibilities under this project will primarily be limited to actions on referrals from other functions, most commonly the examination of suspected church/religious schemes conducted on referrals from the Examination Division, identified through related/affiliated Form 1040 filers screened at the service centers. Suspected Forms 4361, 4029, and/or other documents may also be referred.

(7) Where EP/EO Divisions refer matters identified under this program to the National Office for technical advice, to Appeals offices, or to other concerned Service functions, such referrals should likewise be identified as involving matters subject to the Illegal Tax Protester Program procedures. This is to alert the concerned function and assure that time spent is accurately reported.

7(10)75.63 (8-20-79)
REPORTING REQUIREMENTS

(1) A report, Quarterly Report of Illegal Protester Activity, will be furnished to the National Office on a quarterly basis, that will include the following information:

(a) Number of organizations under examination and pre-examination

1 Beginning of quarter

2 Started during quarter

3 Closed during quarter

4 Open at end of quarter

(b) Number of summonses issued

(c) Number of summonses requiring enforcement actions

(d) Time (hours)

1 Districts, regions and National Office should each report, separately, time spent.

2 Time to be reported is that time spent each quarter on cases under the project guidelines.

(2) The report is to cover only those organizations identified under this project.

(3) A negative report, if applicable, is required.

(4) The report should be forwarded to the Director, Exempt Organizations Division (E:EO:O:P) within 20 workdays from the end of each calendar quarter. Report symbol NO-CP:CI-62 controls this report.

7(10)75.7 (8-20-79)

REFERRALS TO CRIMINAL INVESTIGATION DIVISION

(1) EO specialists should be alert to potential fraudulent schemes employed by mail order ministries. Some of the fraudulent devices used include the following:

(a) Keeping a double set of books;

(b) Giving of false information/documents to the examining specialist;

(c) Concealing or destroying financial records;

(d) Closing out checking and savings accounts at banks and thereafter conducting financial affairs in currency;

(e) Disguising income from an unrelated trade or business as nontaxable income;

(f) Controlling and using funds in the church bank accounts by the reputed minister for his/her own benefit;

(g) Using funds claimed as contributions to the church for personal use of the reputed minister; and

(h) Falsifying application forms which are signed under penalties of perjury.

(2) If, during an examination of a mail order ministry, an EO specialist discovers any firm indications of potential fraudulent schemes, the specialist will suspend his/her activities and prepare a Form 2797, Referral Report for Potential Fraud Cases, to the Criminal Investigation Division. Six copies of Form 2797 will be prepared. One copy of the report is retained with the case file. The original and five copies are forwarded through the group manager to the Chief, EP/EO Division, for comments and signature. One copy is sent to the Examination Division. The original and three copies of the report will be transmitted to the Chief, Criminal Investigation Division, (or District Director in the streamlined districts) in the district in which the entity/taxpayer is located. The remaining copy is retained in the EP/EO Division's referral pending file. A separate Form 2797 will be prepared for each person or entity involved. See also IRM 7(10)85, Fraud Procedures.

(3) When a specialist is requested to participate with a special agent in an investigation, the Chief, EP/EO Division, will assign either the referring or another specialist. Any disagreement between the Criminal Investigation Division and the EP/EO Division, as to whether a specialist should be assigned to cooperate with a special agent in an investigation, will be resolved by the District Director of the district in which the entity is located.

(4) If the Criminal Investigation Division accepts the referral for investigation, the conduct of the investigation becomes the responsibility of the special agent, and the EO specialist will not take any action on the case without first consulting with the special agent who is assigned the investigation.

(5) If an EO specialist learns that an assigned case involves a taxpayer that is the subject of a criminal investigation, all activity on the case will be immediately suspended. The specialist's group

manager will consult with the Criminal Investigation Division concerning the continuance of EP/EO activity on the case. If agreement to either continue the suspension or to resume EP/EO activity on the case cannot be reached at the group or division level, the issue will be decided by the District Director. Where more than one District is involved, the District Director having jurisdiction over the criminal investigation will resolve the question.

(6) In cases that are referred to the Criminal Investigation Division, the specialist will summarize the results of the examination and include this in the case file. It is especially important that statements made by the individual with whom the examination was conducted, be accurately documented in the case file.

7(10)75.8 (8-20-79)

APPLICATION OF PENALTIES

(1) Penalties should be considered by the examiner and asserted when appropriate. This determination will be made on a case-by-case basis. The facts and circumstances in each case will govern the imposition of a penalty.

(2) Guidelines to be used in the application of the negligence penalty imposed by IRC 6653(a) are found in IRM 4563.1.

(a) Examiners should not hesitate to recommend assertion of the negligence penalty in appropriate cases.

(b) The burden of proof in a negligence penalty case is the same for the taxpayer as in a straight deficiency or overassessment case.

(3) Criteria for asserting civil fraud penalties are found in IRM 7(10)86.2.

(4) Civil fraud penalties should not be recommended on cases which have not been referred to the Criminal Investigation Division.

(5) Civil penalties other than fraud may be applied (negligence, delinquency, etc.). However, it should be noted that when a 50% civil fraud penalty is applied, IRC section 6653(d)

prohibits the application of the delinquency penalty with respect to the same underpayment.

(6) If applicable, the private foundation excise taxes under Chapter 42 and related Code provisions should be considered. See IRC 509(b) and section 1.509(b)-1 of the regulations.

7(10)75.9 (8-20-79)
CONSPIRACY

(1) Section 2, 18 U.S.C., Principals, provides:

"(a) Whoever commits an offense against the United States, or aids, abets, counsels, commands, induces or procures its commission, is punishable as a principal."

"(b) Whoever willfully causes an act to be done, which if directly performed by him or another would be an offense against the United States, is punishable as a principal."

(2) Section 371, 18 U.S.C., Conspiracy to Commit Offense or to Defraud United States, provides:

"If two or more persons conspire either to commit any offense against the United States, or to defraud the United States, or any agency thereof in any manner or for any purpose, and one or more of such persons do any act to effect the object of the conspiracy, each shall be fined not more than \$10,000 or imprisoned not more than five years, or both.

"If, however, the offense, the commission of which is the object of the conspiracy, is a misdemeanor only, the punishment for such conspiracy shall not exceed the maximum punishment provided for such misdemeanor."

(3) In the course of conducting examinations, EO specialists may encounter flagrant situations which appear to be in contravention of the Internal Revenue laws and fall within the purview of either Section 2 or 371 of Title 18, U.S.C. If deemed appropriate, the procedures in IRM 7(10)75.7, Referrals to Criminal Investigation Division, supra, should be followed with respect to these cases.

7(10)75.(10) (8-20-79)
DISCLOSURE PROVISIONS

(1) Investigative disclosures may be made as authorized by regulations approved under Section 6103(k)(6) of the Code.

(2) Certain rulings, determination letters and technical advice memorandums requested after October 31, 1976, are subject to public disclosure under either IRC 6104 or 6110. Procedures concerning these matters are contained in 26 CFR 601.105(b)(5) or 26 CFR 301.6110-1.

(3) Local Public Affairs and Disclosure offices should be advised of significant developments relating to mail order ministries, such as revocations and court decisions.