

# I. CHURCHES AND RELIGIOUS ORGANIZATIONS

## 1. Introduction

During the past year, churches and religious organizations continued to present the Service with sensitive questions that intertwined Constitutional rights and federal tax law. The sensitivity was underlined by the fact that the tax concerns of churches were a topic of discussion at the first meeting of the Commissioner's Advisory Group on Exempt Organizations this year. The following discussion will provide an overview of those developments and includes a chart of issues typically found in cases involving churches and religious organizations.

## 2. Legislative Developments

In addition to the general impact on exempt organizations of the separate hearings held by the House Ways and Means Oversight Subcommittee on the subjects of political/lobbying activities and of unrelated business income tax, churches and religious organizations were the specific focus of an Oversight hearing held on October 6, 1987. That hearing concerned television ministries and was intended to review the federal tax rules applicable to such organizations. The Chairman of the Subcommittee, Representative J. J. Pickle, announced that the reason for the hearing was that, "the public contributes millions of dollars each year to television ministries which operate, in full or in part, as tax-exempt organizations." He further stated that, "...it is important that we examine whether the present-law rules are effective in insuring that tax-deductible donations given to television ministries are being used exclusively for exempt purposes." He cautioned, however, that the Subcommittee was not undertaking to investigate any specific ministry or organization, nor were religious practices or beliefs being questioned.

The hearing lasted one day in which testimony was taken from the Treasury Department, the Internal Revenue Service, six evangelists, including Jerry Falwell and Oral Roberts, former Commissioner Egger, and a number of organizations and individuals with an interest in television ministries. Assistant Secretary of the Treasury for Tax Policy O. Donaldson Chapoton and Commissioner Lawrence Gibbs described the special status accorded churches in the Internal Revenue Code, including the IRC 508 notice exception, the IRC 6033 exception from annual information reporting, and the special examination procedures of IRC 7611. The Commissioner noted that the resulting lack of information hampers efficient

administration of the tax laws and that the only sanction available to deal with transgressors is the severe one of revocation of exemption. A number of witnesses from religious organizations, however, maintained that strengthened efforts at self-regulation would be more effective and would pose less of a threat to religious freedoms.

### 3. Litigation Update

For a number of years, Continuing Professional Education texts have chronicled the movement of Abortion Rights Mobilization, Inc. v. Baker through the court system. During the preceding year, the movement continued. As discussed in last year's text, in 1986 the U.S. District Court for the Southern District of New York held in contempt and imposed a fine on two organizations that are not parties to the litigation, the United States Catholic Conference (USCC) and the National Conference of Catholic Bishops (NCCB), for refusing to comply with subpoenas. The subpoenas had been issued in the wake of judicial decisions finding standing on the part of Abortion Rights Mobilization to contest the Service's continued recognition of exemption of the Catholic Church. The contempt order was appealed by the USCC and the NCCB on the ground that the district court lacks jurisdiction over the underlying action because of ARM's lack of standing to sue, again raising the issue of standing. On June 4, 1987, the Second Circuit concluded that the USCC and the NCCB may, as non-party witnesses, "challenge their contempt adjudication only on the limited ground that the District Court lacks even colorable jurisdiction over the underlying lawsuit." The Appeals Court then applied the rule to the case and determined that the contempt issue could not be used as a vehicle for challenging ARM's standing as the district court has "colorable" jurisdiction to hear the case based on ARM's claim of injury arising from the Service's administration of the IRC 501(c)(3) political activities proscription. Accordingly, witnesses such as the USCC and the NCCB must comply with the subpoenas. On September 11, 1987, the two organizations filed a petition requesting Supreme Court review of the Second Circuit decision. The Department of Justice has also filed a brief for respondents. On December 7, 1987, the Supreme Court agreed to hear the case. It is thus likely that the standing issue will be considered by the Supreme Court.

The Supreme Court will also likely be asked to review the issue of whether payments to the Church of Scientology for participation in church activities, principally auditing sessions and doctrinal courses, are deductible as charitable contributions under IRC 170. The issue is being litigated in every federal circuit in the United States and, to date, the First, Fourth, and Ninth Circuits have agreed

with the Internal Revenue Service that the fees charged are not gifts as they are required for participation in the activity. See Hernandez v. Commissioner, 819 F.2d 1212 (1st Cir. 1987), Ethel B. Miller v. IRS, No. 86-2090 (4th Cir. Sept. 18, 1987), Graham v. Commissioner, 822 F.2d 844 (9th Cir. 1987). However, the Eighth Circuit has disagreed and refused to place an economic value on religious participation. The court concluded that "regardless of the timing of the payment or details of the church's method of soliciting contributions from its members, an amount remitted to a qualified church with no return other than participation in strictly spiritual and doctrinal religious practices is a contribution within the meaning of section 170." See Maureen A. Staples v. Commissioner, 821 F.2d 1324 (8th Cir. 1987).

The Supreme Court has ruled in one Scientology case involving the Freedom of Information Act. In a 6-0 decision in Church of Scientology of California v. Internal Revenue Service, (S. Ct. Dkt. No. 86-472, decided November 10, 1987), the Court affirmed a decision of the District of Columbia Circuit that tax return information may be released only if it is not in its original form so that the origin of the information is disguised. The Church had sought access to information filed by others with the Service with only the identifying information removed.

The Ninth Circuit was active in a second Scientology case in 1987 as it affirmed the 1984 Tax Court case upholding the revocation of exemption under IRC 501(c)(3) of the Church of Scientology of California based on inurement of earnings of the organization to the benefit of its founder, L. Ron Hubbard, and his family. See Church of Scientology of California v. Commissioner, 823 F.2d 1310 (9th Cir. 1987).

An additional court decision involving churches is Universal Life Church, Inc. v. United States, Cl. Ct. No. 583-84T, filed November 10, 1987. In that case, involving the parent Universal Life Church organization, the court granted a government motion for summary judgment based on the position that the Universal Life Church is not being operated exclusively for exempt purposes but, rather, that the organization has the substantial nonexempt purposes of giving tax advice not incidental to religious purposes and promoting tax avoidance. The court noted that the Church failed to advance any plausible argument, evidence, or averment that would justify a trial.

The final significant litigation development during the year concerned the Foundation of Human Understanding, an IRC 501(c)(3) organization seeking public charity classification as a church under IRC 170(b)(1)(A)(i). On May 19,

1987, the Tax Court held that the Foundation, whose primary activities were religious broadcasting and publishing, possessed associational aspects that were much more than incidental. See Foundation of Human Understanding, 88 T.C. No. 75 (May 19, 1987). That is, the organization had a congregation of its own even though it continued to have a large broadcasting activity. During the years in question, the organization had approximately 2,000 followers and attendance of between 50 and 350 at religious services. Between 45% and 49% of its total expenditures were related to the broadcast activity. The organization had a distinct religious creed and form of worship. In addition to its broadcasts, publications, and worship services conducted by its ordained ministry for the public, it offered religious instruction as part of the general educational curriculum of a school it operated. Accordingly, the Tax Court concluded that the Foundation constituted a church within the meaning of IRC 170(b)(1)(A)(i) even though the congregation and its activities were a relatively small part of the organization's overall activities.

#### 4. Conclusion

As described in the preceding discussion, a number of events occurred during 1987, both in the legislative and the litigation arenas, that have a potential for dramatically changing the Service's administration of the tax laws applicable to churches. Whether legislative initiatives emerge from the Oversight hearings or whether court developments will expand or contract the scope of the Service's authority in the area, or grant standing to third parties seeking to enjoin the Service to take specific action against exempt churches, remains to be seen. It appears likely that 1988 will answer some of these questions.

**[Appendix 1-3 not shown]**