TO: Senator Grassley
CC: Senate Finance Committee files
FROM: Theresa Pattara & Sean Barnett
RE: Review of Media-Based Ministries
DATE: January 6, 2011

Staff Work

Pastor Hinn and Joyce Meyer complied with your request and engaged staff in constructive, open dialogue. Through our review of their responses as well as our conversations with their representatives, we learned that they each had separately undertaken significant reforms, some of which began before your inquiry. These reforms are outlined in the letters they submitted to you, which are attached. The reforms undertaken by Pastor Hinn and Joyce Meyer are extensive and are to be commended. Staff completed its review of these organizations as a result of these reforms. Joyce Meyer Ministries also became a member of the Evangelical Council for Financial Accountability in March, 2009.

The other four either did not provide a response or provided incomplete responses. As a result, Committee staff obtained information about these churches from public sources and third party informants. Informants were either current or former officers, directors, and key employees, current or former members, or watch dog groups. Overviews of each of the four are attached.

Issuance of Subpoenas

While gathering the requested information on the four churches from other sources, we also continued to reach out to the lawyers for the four churches. When it became obvious that we would not be receiving complete responses, we entered into conversations with the Chairman's staff as well as Senate Legal Counsel to issue subpoenas. We noted that the subpoenas you had agreed to issue as Chairman or Ranking Member had all been "friendly". That is, they were issued to an individual who wanted to provide information to the Committee but needed to be protected by a subpoena request.

As noted above, we spoke with several informants in completing our reviews of the four churches did not comply with your requests. Almost all of those who spoke with us insisted on complete anonymity while others were too frightened to speak with us even anonymously. Some had received warnings from the churches that they would be sued if they violated confidentiality agreements they had signed. Even though we explained that a subpoena should protect them from retaliation, including lawsuits, some became even more frightened when offered a "friendly" subpoena. They became concerned about needing an attorney and still feared retaliation by the churches. As a result, we believed that issuing subpoenas to informants would be counterproductive.

Separately, Committee rules regarding the issuance and enforcement of subpoenas require the participation of the Chairman. In addition, significant Committee and Senate Legal Counsel resources would be needed to issue and enforce the subpoenas, since we the four churches would likely challenge any subpoenas issued to them. The Committee's consideration of health reform legislation, which began in the winter of 2009, ensured that we would not have the time or resources to issue and enforce the subpoenas. As a result, staff also decided against issuing subpoenas to the churches.

Tax Status of the Ministries

Note that each of the six "ministries" classifies itself as a "church". As a result, they did not have to file a Form 1023, *Application for Recognition of Tax-Exemption*, and do not have to file a Form 990, *Return of Organization Exempt from Tax*, with the Internal Revenue Service (IRS). However, we did search Guidestar.org for related organizations and asked the IRS to do the same. With very limited exception, we did not find a Form 990 for any of the churches or their related organizations.

As indicated in the separate summary for each church, there are multiple for-profit and non-profit entities related to each church. Multiple "assumed" or "doing business as" names were also used. Regarding the non-profit organizations, a Form 990 generally was not found on Guidestar.org. It is safe to assume that some of these entities are deemed "integrated auxiliaries" of the church and therefore are exempt from filing the Form 990.

The number and types of entities, including private airports and aircraft leasing companies, raises concerns about the use of the church's tax-exempt status to avoid taxation. However, given the four churches' refusal to provide tax information, we are unable to determine whether and the extent to which they are reporting and paying taxes on income earned in those entities.

Other Organizations Referred to the Committee

After the letters went out to the six churches, constituents from across the country wrote requesting congressional investigations of other churches and religious organizations. Concerns and complaints were similar to those regarding the six and were mainly focused on use of organization funds for compensation and other perks. Another complaint focused on fundraising practices, particularly those that targeted the sick and elderly. Lack of transparency regarding finances and related party transactions was another top issue.

The organizations included several media ministries, several other non-denominational churches, some Catholic and Baptist churches, the Church of Scientology, Kabballah Centres, the New York City mosque being built near the World Trade Center site, a church that sends prayer solicitations via mail with requests for donations, and a voodoo church that solicits donations through its website. While we did not contact these organizations directly, we researched news stories, viewed Forms 990 from

Guidestar.org, and, in some cases, spoke with third parties knowledgeable about the organizations.

Issues for Consideration

Tax provisions affecting churches and religious organizations are similar to the general charity provisions in that they have not been updated in decades. Fraudulent solicitations by a Catholic order of priests in the mid-1970s, and the resulting proposed legislation in 1977, was the impetus for the creation of the Evangelical Council for Financial Accountability (ECFA) in 1979. (See Appendix A for more information). Less than ten years later, in 1987, the House Ways and Means Committee conducted extensive hearings on the Jim and Tammy Faye Bakker scandal. (See Appendix B for more information).

More than thirty years after the Catholic order scandal and more twenty years after the Bakker scandal, it is common to hear about religious organizations being "a reinvented form of the money-positive strand of televangelism that was disgraced with the scandals involving Jimmy Swaggart and Jim Bakker".[1]

In 1987, then-Congressman Dorgan posed the following question: "What kind of accountability is now required; what kind of information is required, is information sufficient now, is it available to allow those to whom the appeal for funds is directed to make reasonable decisions about the advisability of contributions?"[2]

Our review of the six media-based ministries as well as the others indicates that these questions are still relevant today. While the majority of churches and religious organizations operate with policies and procedures that make them accountable to their members, it is the small minority that don't that are subject to scrutiny by the members and the public, including the press. These outliers present tax policy issues for consideration.

Appendix C contains a list of these issues specific to churches and religious organizations. Appendix D contains a list of issues raised by our review of churches and religious organizations but are actually applicable to all 501(c)(3) charitable organizations, and in the case of excess benefit transactions, to organizations exempt under sections 501(c)(3) and 501(c)(4) of the tax code.

The electioneering prohibition imposed on charities puts the IRS in a very difficult position as it juxtaposes tax-exemption requirements with freedom of speech limitations. With respect to churches and religious organizations, many may view such free speech limitations as a violation of constitutional principles. IRS enforcement of this prohibition can never be effective as IRS agents rarely witness violations of the prohibition. As a result, the IRS has to rely on third party referrals. Auditing violations of this prohibition

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[1] Sarah Barmak, A Bear Market for Prosperity Theology, Toronto Star, Oct. 11, 2008, at ID01.
[2] Federal Tax Rules Applicable to Tax-Exempt Organizations Involving Television Ministries: Hearing Before the Subcomm. on Oversight of the House Comm. on Ways and Means, 100th Cong. 8 (1987).

essentially boil down to the IRS refereeing who said what, when. While political activity was not a central issue raised in the review of the media based ministries, it is one of the greatest sources of tension between the IRS and religious organizations. As a result, we thought it appropriate to consider this issue and seek input on how to amend these rules while seeking input on the other tax issues. Appendix E contains a description of the current law.

For the tax issues presented, a discussion of the present law and a description of the issue also are included. The questions we raise are not exclusive or comprehensive, as we expect those responding to the issues to raise further questions.

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APPENDIX A: Background on the ECFA

On January 4, 1977, Rep. Charlie Wilson introduced H.R. 41, which was a bill "to require the furnishing of certain information in connection with the solicitation of charitable contributions by mail." According to a 1978 Time Magazine article, Rep. Wilson introduced this bill in response a fundraising scandal involving the Baltimore branch of the Pallottine order of Roman Catholic priests.[3]

According to a summary available on http://www.thomas.gov, the bill:

- Requires charitable organizations which solicit, by any means, the remittance of a contribution by mail to include with such solicitation: (1) the legal name and principal address of the organization; (2) the purpose of the solicitation and intended use of the contribution; (3) the obligation of the organization to furnish the information required by this Act; and (4) the percentage of all such contributions remaining for direct application to charitable purposes, after deducting total administrative costs, during the most recent complete fiscal year, or in some cases the fiscal year preceding such fiscal year.
- Directs that all of the above information be transmitted, whether in writing or by radio or television, conspicuously in a non-technical, readily understandable manner. Requires that such organization furnish, upon request, such audit reports, accounts, or other information as the Postal Service may require to establish or verify the information included in the solicitations.
- Requires such organizations to furnish within 30 days to anyone who has been solicited and so requests, pertinent financial information reasonably sufficient to verify any information included in the solicitation.
- Sets forth the method by which such organizations with outside income may distribute administrative costs.
- Exempts from these requirements: (1) membership organizations when soliciting their own members; (2) schools, colleges, and universities when soliciting their students, alumni, faculty, governing boards, committees, or family members of such individuals; and (3) charitable organizations authorized by and exclusively making expenditures to a school, college, or university when soliciting such individuals.

Senator Mark Hatfield may have considered introducing Rep. Wilson's bill in the Senate. However, later that year, it is widely reported that he "addressed a group of key

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[3] "Religion: Radix Malorum Est Cupiditas?", Time Magazine, January 23, 1978 available at http://www.time.com/time/magazine/article/0,9171,919320,00.html

Christian leaders and challenged them to police their own mission agencies as a "Christian Better Business Bureau" or face the potential of government intervention"[4].

As a result, it is understood the Billy Graham Evangelistic Association joined with World Vision to found the Evangelical Council for Financial Accountability (ECFA). According to ECFA's member profile, the Rev. Graham's organization is a charter member and has been a member since December 1, 1979.[5]

[4] http://www.ecfa.org/Content/GeneralBackground
[5] http://www.ecfa.org/MemberProfile.aspx?ID=4764

APPENDIX B: Summary of Jim & Tammy Faye Bakker Case

On March 18, 1987, James Bakker resigned as president and chairman of the board of the PTL Club, the television ministry he founded with his wife, Tammy Faye Bakker. Mr. Bakker resigned after confessing to a "sexual encounter" with a church secretary, Jessica Hahn, in 1980.[6] Bakker had been head of a Christian broadcasting empire that reached 13 million viewers a day as well as a 2,300 acre Christian resort, Heritage USA, near Fort Mill, S.C. In early May 1987, Bakker was expelled from the Assemblies of God denomination amid the disclosure that PTL had paid Ms. Hahn $265,000 to buy her silence. At the same time, news was circulating that the Bakkers had been paid about $1.6 million in bonuses and salaries in 1986 and $4.6 million over the preceding 39 months, and that their possessions included a 55-foot houseboat, a $45,000 Mercedes-Benz, a $55,000 Rolls-Royce, and homes and apartments in Tega Cay, S.C., Gatlinburg, Tenn., Palm Springs, and Highland Beach, Fla. After his resignation, Bakker fled the $1.3 million parsonage he occupied as PTL leader and took refuge in his Palm Springs mansion.[7]

In June 1987, the PTL ministry filed for court protection from its creditors under federal bankruptcy laws. PTL officials blamed Bakker for PTL's financial problems, but Bakker denied any serious financial wrongdoing, saying, "We preach prosperity. We preach abundant life."[8] Later that year a federal grand jury began investigating whether the Bakkers and their top former associates should be charged with crimes connected with their mismanagement of the PTL ministry,[9] and major contributors to PTL filed a $758 million racketeering and fraud suit against Bakker and several associates, alleging widespread fraud in obtaining donations from "lifetime partners."[10]

On April 22, 1988, the Internal Revenue Service revoked the tax-exempt status of the PTL ministry, based on an examination of PTL's records in bankruptcy court. The IRS report concluded that Jim and Tammy Bakker and their aides profited excessively from donations to the ministry, and that the operations of Heritage USA theme park were commercial rather than religious.[11]

On November 10, 1988, a federal bankruptcy judge ordered Jim and Tammy Bakker, and the former vice-president of PTL and administrative assistant to Bakker, David Taggart, to repay $7.7 million to PTL for reaping undeserved profits and mismanaging the television ministry. The judge said the expenditures at PTL under Bakker were "unbelievable" and a "waste of PTL's money." Accusing Bakker and Taggart of "gross mismanagement" and "total disregard for reality," the judge said that the two had

[6] Wayne King, Bakker, Evangelist, Resigns His Ministry Over Sexual Incident, N.Y. Times, March 21, 1987, at 11.
[7] William E. Schmidt, For Jim and Tammy Bakker, Excess Wiped Out a Rapid Climb to Success, N.Y. Times, May 16, 1987, at 18.
[8] Gary Klott, PTL Asks Court For Protection From Creditors, N.Y. Times, June 13, 1987, at 11
[9] Grand Jurors Open Inquiry on PTL Ministry, N.Y. Times, Aug. 18, 1987, at A17.
[10] Racketeering Suit Filed Against PTL Ministry, N.Y. Times, Nov. 19, 1987, at D30.
[11] I.R.S. Revokes PTL Tax Exemption, N.Y. Times, Apr. 23, 1988, at 18.

"approached the management of the corporation with a reckless indifference to the financial consequences of their acts."[12]

On December 5, 1988, Bakker and the former chief operations officer of PTL, Richard Dortch, were indicted on federal charges of defrauding as many as 150,000 contributors and diverting more than $4 million for their personal use. According to the indictment, the two men deliberately misled contributors and PTL board members in soliciting contributions of more than $158 million from "lifetime partners," money that was never used for intended purposes. The solicitations – made by way of television appeals, mailings and telephone calls – sought "lifetime partners" who would pay from $1,000 to $10,000 for the guarantee of free lodging once a year in any of the planned hotels, motels, and campgrounds at Heritage USA. Of the two planned hotels, only one was completed. Bakker sold more than 66,000 partnerships in the Heritage Grand Hotel, though he promised followers that only 25,000 would be sold. And he sold 74,000 partnerships in the never-finished Towers Hotel, though he said only 30,000 would be sold. Other projects that Bakker had promised the lifetime partners – including an inn and campground – were never built. Instead, the money went toward bonuses for Baker and his wife ranging from $740,000 in 1984 to $1,055,000 in 1986. During the same period, Mr. Dortch received bonuses of $550,000. In a separate indictment, David Taggart and his brother, James Taggart, who was employed by PTL as an interior designer, were charged with diverting $1.1 million from PTL for personal use and not reporting the income to the IRS.[13] Richard Dortch was sentenced to eight years in prison and a $200,000 fine for wire fraud and conspiracy.[14] David and James Taggart were convicted on charges of tax evasion and conspiracy. Each was sentenced to 18 years in jail and fined $500,000.[15] And in October 1989, Jim Bakker was convicted on 24 counts of fraud and conspiracy, sentenced to 45 years in prison, and fined $500,000.[16]

Amid the controversy swirling around the Bakkers and PTL, the Subcommittee on Oversight of the House Committee on Ways and Means held a hearing to review the federal tax laws applicable to tax exempt organizations conducting television ministries "to ensure … that tax-deductible contributions are spent only for religious and charitable purposes."[17] The October 6, 1987, hearing was called because, in the words of then-Congressman Byron Dorgan,

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[12] Bakker and Ex-Aide Are Ordered to Pay $7.7 Million to PTL, N.Y. Times, Nov. 11, 1988, at A27.
[13] Ronald Smothers, Bakker and Ex-Aide Are Charged With Defrauding Donors to PTL, N.Y. Times, Dec. 6, 1988, at A1.
[14] Bakker Aide Receives 8-Year Fraud Sentence, N.Y. Times, Aug. 25, 1989, at D18.
[15] 2 Former PTL Aides Sentenced to Jail, N.Y. Times, Sept. 9, 1989, at 16.
[16] Peter Applebome, Bakker Is Convicted on All Counts; First Felon Among TV Evangelists, N.Y. Times, Oct. 6, 1989, at A1; Peter Applebome, Bakker Sentenced to 45 Years For Fraud in His TV Ministry, N.Y. Times, Oct, 25, 1989, at A1.
[17] Federal Tax Rules Applicable to Tax-Exempt Organizations Involving Television Ministries: Hearing Before the Subcomm. on Oversight of the House Comm. on Ways and Means, 100th Cong. 4 (1987) (statement of Hon. J.J. Pickle, Chairman, Subcomm. on Oversight)

…Television evangelism has been one of America's growth industries in the last decade. In addition to using the technology of television to spread the Word of the Lord, evangelists have also discovered that the electronic collection plate can be very lucrative, and that collection of enormous amounts of money provides evangelists not only with substantial opportunities to do good but also serious obligations. While it is true that the exceptions have gotten most of the attention, it is clear that at least some evangelists have not been able to maintain accountability for the vast sums that they have collected. The stories of million-dollar salaries, million-dollar jets, and houses from Malibu to Miami raise not only eyebrows, but also some questions of reporting and accountability."[18]

[18] *Id.* at 8.

Appendix C: Church & Religious Organization Issues for Consideration

1) Advisory Committee for Churches & Religious Organizations

The IRS currently sponsors several advisory committees under the Federal Advisory Committee Act, including the Advisory Committee on Tax-Exempt and Government Entities (ACT). While the ACT has had members from churches and religious organizations, the ACT is not dedicated solely to those organizations. We recommend that the IRS sponsor an advisory committee comprised of representatives of churches and religious organizations, including practitioners or other experts, and that would consider only issues related to churches and religious organizations.

We believe that such a Committee would be helpful in facilitating an ongoing dialogue between churches and religious organizations and the IRS. Through our discussions with various stakeholders after the letters went out to the six churches, we perceived there to be a very high level of distrust between churches and religious organizations and the government.

This was most evident in your May 2008 meeting organized by the Alliance Defense Fund and that was attended by representatives from The Family Research Council, Focus on the Family, National Religious Broadcasters and others. The meeting was eye opening for us since, as tax professionals, we were not aware of non-tax issues that posed a threat to the operation of churches and religious organizations. This group specifically raised concerns about the Employment Non-discrimination Act (ENDA), which is not a tax issue.

We propose that, while the new advisory committee may be sponsored by the IRS, other federal agencies with significant interaction with churches and religious organizations should also participate in this committee. Such agencies could include the Federal Election Commission, Federal Communications Commission, the Federal Trade Commission, and possibly the White House Office of Faith Based and Community Organizations.

A federal advisory committee for churches and religious organizations would hopefully result in a proactive and collaborative approach to compliance with federal laws, with a focus on education and outreach, as opposed to a reactive, enforcement-oriented approach. Such a committee could, for example, take on responsibilities similar to the IRS Art Advisory Panel.[19]

2) Parsonage Allowances

Present law

[19] See http://www.irs.gov/individuals/article/0,,id=96804,00.html for more information.

Under section 107(1),[20] the rental value of a home furnished to a minister of the gospel as part of compensation for services is not included in the minister's gross income for federal income tax purposes.

Under section 107(2), any rental allowance paid to a minister of the gospel as part of compensation for services that are ordinarily the duties of a minister of the gospel is not included in gross income of the minister for federal income tax purposes, but only to the extent that the allowance is used for housing or rental expenses and does not exceed the fair rental value of the home, including furnishings, appurtenances such as a garage, and utilities. This rental allowance is commonly referred to as a "parsonage allowance." To qualify for the section 107(2) exclusion, an amount paid to a minister to rent or otherwise provide a home must be designated by the employing church as a rental allowance pursuant to official action taken in advance of such payment as evidenced in an employment contract, in the minutes of (or a resolution by) the church's governing body, in the budget, or in some other appropriate official instrument.

Although section 265 generally disallows a deduction for expenses allocated to tax-exempt income, section 265(a)(6)(B) creates an exception by allowing the recipient of a rental allowance excludable from gross income under section 107 to deduct mortgage interest (under section 163) and real property taxes (under section 164) on his or her home.

Discussion

Congress first excluded from gross income the rental value of parsonages furnished to ministers of the gospel in the Revenue Act of 1921.[21] That provision, which was essentially equivalent to present section 107(1), was limited to clergy living in church-owned houses where no actual cash flowed from the church to the minister. Ministers who received cash to compensate for the lack of a parsonage felt themselves at a disadvantage because they had to pay tax on the additional income.[22]

In 1954, Congress adopted section 107(2), thereby allowing a minister of the gospel to designate a portion of compensation as a housing allowance and exclude that amount from income. According to the committee report on the provision, the original statute was "unfair to those ministers who are not furnished a parsonage, but who receive larger salaries (which are taxable) to compensate them for expenses they incur in supplying their own home. Both the House and your committee [have] removed the discrimination in existing law by providing that the present exclusion is to apply to rental allowances paid to ministers to the extent used by them to rent or provide a home."[23]

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[20] Unless otherwise specified, all section references are to the Internal Revenue Code of 1986, as amended, and the regulations thereunder.
[21] Pub. L. No. 67-98, § 213(b)(11), 42 Stat. 239 (1921).
[22] Kamron Keele, A Plea For the Repeal of Section 107: No More Tax-Free Mansions For Dubious "Ministers of the Gospel," 56 Tax Law. 73, 77 (2002).
[23] S. Rep. No. 83-1622, at 16 (1954).

Congressman Peter Mack, the sponsor of the provision, was more forthcoming about his motives:

> Certainly, in these times when we are being threatened by a godless and antireligious world movement, we should correct this discrimination against certain ministers of the gospel who are carrying on such a courageous fight against this foe. Certainly, this is not too much to do for these people who are caring for our spiritual welfare.[24]

Congressman Mack was moved, in part, by reports that the clergy generally earn less than people working in other occupations.

> Of our clergymen, 55 percent are receiving less than $2,500 per year. This is some $256 less than the $2,668 annual median income for our labor force. It is well to keep in mind that many of these clergymen support families like the rest of us, and that many of these clergymen still receive low income based on the 1940 cost of living but must pay 1953 rents for a dwelling house.[25]

Section 107(2) was enacted before the advent of television ministries and megachurches. The use of that section's provisions by millionaire televangelists has not been without controversy.

As head of the PTL ministry, Jim Bakker lived in a "$1.3 million waterfront home" owned by the ministry.[26] The Bankruptcy Court, in 1988, ordered Jim Bakker to repay PTL nearly $5 million for excessive salaries and bonuses, misuse of corporate funds, and breach of fiduciary duty, noted in its opinion that PTL, which had paid Bakker remuneration totaling $4,326,169 over PTL's four fiscal years from May 31, 1983, through May 31, 1987, had not only paid Bakker a housing allowance of not less than $2,000 per month, but, in addition, had paid the utilities used at the parsonage occupied by Bakker. Utility expenses incurred for power and water often exceeded $1,000 per month and, occasionally, $2,000 per month.[27]

In 1993, the Rev. Leroy Jenkins, the president of Leroy Jenkins Evangelistic Association and pastor of Healing Hill Church in Delaware, Ohio, was charged with two counts of income tax evasion. According to reports, Jenkins had bought a house in Tampa, Florida, because he was spending most of his time in Florida conducting crusades. The attorney for the Association told church officials that they could consider Jenkins's Florida house a parsonage, and that the payments the Church made on Jenkins's mortgage could be considered a non-taxable parsonage allowance, even though the Church already provided Jenkins a parsonage in Delaware, Ohio. The IRS assessed

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[24] H.R. Comm. on Ways and Means, Hearings on Forty Topics Pertaining to the General Revision of the Internal Revenue Code, 83rd Cong. 1576 (1953).
[25] *Id.* at 1575.
[26] Bakkers Given Time to Move, N.Y. Times, June 15, 1987, at A14.
[27] Benton v. Bakker (*In re* Heritage Vill. Church and Missionary Fellowship), 92 B.R. 1000, 1008-09 (Bankr. D.S.C. 1988).

additional taxes in 1987 and 1988, saying that the mortgage payments and upkeep costs paid by the Church on the Florida house were taxable income to Jenkins.[28]

According to records in a civil lawsuit, televangelist Walter V. Grant was receiving a $175,000-a-year parsonage allowance before he was imprisoned for income tax evasion in 1995.[29]

According to a report in the L.A. Times, televangelist Paul F. Crouch, president of Trinity Broadcasting Network, makes a habit of ordaining the network's station managers and department heads as ministers so that they could deduct 100% of their housing costs as a "parsonage allowance."[30]

Rick Warren is a minister and the founder of Saddleback Valley Community Church. According to a church press release, Saddleback was the fourth-biggest church in the United States in 2007, with 22,000 people in weekly attendance served by more than 300 ministers.[31] In 1992, Warren bought a house for $360,000. In 1993, the Church paid Warren $77,663, and Warren excluded the entire amount from income as a housing allowance. In 1994, the Church paid Warren $86,175, and Warren excluded $76,300 from income as a housing allowance. In 1995, the Church paid Warren $99,653, and Warren excluded $84,278 from income as a housing allowance.

The IRS, contending that the amount excludable from income under section 107(2) could not exceed the fair market rental value of the home, assessed deficiencies and penalties on the difference between the rental value of Warren's home and the amount Warren excluded from income. The Tax Court held that the section 107(2) exclusion is not limited to the fair market rental value of the home, but to the amount used to provide a home.[32] The case was appealed to the U.S. Ninth Circuit, which appointed Erwin Chemerinsky as amicus to brief the court on whether to it should consider the constitutionality of section 107(2) and whether Warren's claimed exclusion violates the Establishment Clause because it provides a tax benefit available only to "ministers of the gospel." The appeal was dismissed[33] when the Clergy Housing Allowance Clarification Act of 2002 (CHACA)[34] was enacted. CHACA adopted the IRS interpretation of the statute and provides that the housing allowance is limited to the fair rental value of a minister's housing. But it also specifies that this interpretation applies only prospectively and not to the tax years involved in the Warren dispute. The

[28] Randall Edwards, Jenkin's Attorney: Home was Parsonage, Columbus Dispatch (OH), Mar. 18, 1993, at 02C.
[29] David Cay Johnston, Your Taxes: From Holy Men to Houses, A World of Tax Breaks, N.Y. Times, Mar. 1, 1998, at 31.
[30] Mark I. Pinsky, Christian Broadcaster Defends Methods: Acquisition of Station, Treatment of Employees Under Question, L.A. Times, Apr. 9, 1989, at 27.
[31] http://www.rickwarrennews.com/saddleback.htm
[32] Warren v. Comm'r, 114 T.C. 343 (2000).
[33] Warren v. Comm'r, 302 F.3d 1012 (9th Cir. 2002).
[34] Pub. L. No. 107-181, 116 Stat. 583 (2002). H.R. 4156, 107th Cong. (2002), passed the House by a unanimous vote and the Senate by unanimous consent.

sponsors of CHACA explained that the bill was designed to prevent the Ninth Circuit from considering the constitutionality of section 107(2).

As did the legislative history of the original section 107(2) in 1953, the legislative history of the 2002 CHACA evidences a particular concern for clergy of modest means ministering to small and rural churches. During consideration of the House bill, Congressman Earl Pomeroy of North Dakota made this observation:

> If the housing exclusion is struck down … churches, which already operate on the thinnest of margins, would be unable to offset this tax increase and, as a result, many could actually lose the services of their clergy. Rural churches are especially vulnerable…. North Dakota has more churches per capita than any other State in the country, more than 2,000 churches, 78 percent of which are located in communities of under 2,500 people. These are congregations just struggling to get by. We have already lost 400 churches over the last several years ….[35]

Senator Baucus, who co-sponsored the Senate version of the bill with Senator Grassley, stated that—

> The vast majority of clergy across America work very hard for very modest pay. Especially in rural areas like we have in Montana, many congregations are small, pay is low, and ministers are very dependent upon their churches providing or paying for their housing.[36]

The parsonage allowances provided by small, rural churches, however, are generally not the ones that attract the attention of the media and the public. The ones provided by churches with denominational or similar oversight also do not attract attention. Press reports generally focus on the ministers living in multi-million dollar mansions.[37] The value of the houses owned by the churches reviewed by the Committee dwarf that of the house provided to Jim Bakker when he was head of PTL. See the individual church summaries for details about the values of each of their parsonages.

Note that the U.S. Bureau of Labor Statistics reports that the average housing expenditure for all households in the United States in 2007 was $16,920.[38]

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[35] Cong. Rec. H1300 (Apr. 16, 2002)
[36] Cong. Rec. S2957 (Apr. 18, 2002)
[37] *See, e.g.,* William Symonds, Earthly Empires: How Evangelical Churches are Borrowing From the Business Playbook, Bus. Wk., May 23, 2005, at 78; Michael Luo, Preaching a Gospel of Wealth In a Glittery Market, New York, N.Y. Times, Jan 15, 2006, at 11; Martin C. Evans, Their Faith In the Dollar, Newsday, Nov. 12, 2006, at A24; Kent Garber, Preaching a Gospel of Excess?: A Senator Probes the Finances of Celebrity Televangelists, U.S. News & World Rep., Feb. 25, 2008, at 16; Eric Gorski, Televangelist Shares His Wealth – With Family and Church Board, St. Louis Post-Dispatch, July 27, 2008, at A3.; Televangelist's Jet Not Tax-Exempt, Hous. Chron., Dec. 11, 2008, at B10.
[38] http://www.stats.bls.gov/news.release/cesan.htm

The value of the parsonage and housing allowances is separate from the issue of who is a "minister" eligible for the exclusion. Some of the organizations reviewed by the Committee provide parsonage or housing allowances to family members and employees who may be deemed ministers solely to be eligible for the income tax exclusion.

Committee staff first became aware of potential abuses in the classification of the ministers when the Volunteers of America (VoA) responded to your March 24, 2005, letter. In its response, VoA explained that it is an ecumenical Christian church and is classified as a church or a convention or association of churches. After receiving this response, a VoA insider met with Committee staff. The insider provided a list of almost 200 employees who were designated as "ministers" for tax purposes.

In addition, the Clergy Housing Allowance Clarification Act of 2002 did not resolve the Establishment Clause issue raised in the appeal of the Warren case to the Ninth Circuit. The section 107 exclusion, insofar as it benefits only "ministers of the gospel," is vulnerable to the charge of being an unconstitutional establishment of religion.[39]

Another issue is whether ministers should receive a parsonage allowance for more than one residence. As noted above, Congressional intent with respect to the original 1953 provision and the subsequent 2002 amendment appears to be focused on the ability of small, rural churches to attract and retain ministers. It is not clear whether Congress intended to allow churches to provide, or ministers to receive allowances for, more than one residence or a vacation home.

In Driscoll v. Commissioner, the IRS challenged a minister's exclusion for a second home under the premise that Congress only intended to provide the income tax exclusion for one home. The ministers in this case had a second home that was on a lake. In a 7-6 decision, the Tax Court ruled that no such limitation could be interpreted from the statutory language.[40]

Issues for Consideration

Should the parsonage allowance be limited to a single primary residence or to a specific dollar amount?

To withstand further constitutional scrutiny, should section 107 be amended to broaden its applicability?[41]

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[39] *See e.g.*, Ellen P. Aprill, Parsonage and Tax Policy: Rethinking the Exclusion, Tax Notes Today, Aug. 27, 2002, 2002 TNT 166-18; Erwin Chemerinsky, The Parsonage Exemption Violates the Establishment Clause and Should Be Declared Unconstitutional, 24 Whittier L. Rev. 707 (2003); Karmon Keele, A Plea For the Repeal of Section 107: No More Tax-Free Mansions for Dubious "Ministers of the Gospel", 56 Tax Law 73 (2002).

[40] 135 T.C. 27 (2010)

[41] Model statutory language can be found in Ellen P. Aprill, Parsonage and Tax Policy: Rethinking the Exclusion, Tax Notes Today, Aug. 27, 2002, 2002 TNT 166-18.

Should the parsonage allowance be limited to a more select group of individuals?

3) IRS Filing Requirements

Present law

Section 6033(a)(1) requires organizations exempt from tax under section 501(a) to file an annual return.

Section 6033(a)(3)(A)(i) excepts churches, their integrated auxiliaries, and conventions or associations of churches from the section 6033(a)(1) filing requirement.

Section 6033(a)(3)(A)(ii) excepts from the section 6033(a)(1) filing requirement any organization (other than a private foundation) the gross receipts of which are not normally more than $25,000 in each taxable year.[42]

Section 6033(a)(3)(A)(iii) excepts from the section 6033(a)(1) filing requirement "the exclusively religious activities of any religious order."

Section 6033(a)(3)(B) authorizes the Secretary of the Treasury to except other organizations from filing annual returns where the Secretary determines that such filing is not necessary to the efficient administration of the internal revenue laws.

Section 6033(i) requires any organization that does not file an annual return because its annual gross receipts are not normally more than $25,000 to instead file an annual notice, in electronic form, containing basic information about the organization, such as its name, address, EIN, name and address of a principal officer, and evidence that it is exempt from the annual return filing requirements of section 6033(a)(1).

If an organization that is required to file an annual return under section 6033(a)(1) or an electronic notice under section 6033(i) fails to file for 3 consecutive years, the organization's exemption from tax under section 501(a) is considered revoked under section 6033(j)(1) on and after the date set for filing the third annual return or notice. Under section 6033(j)(2), an organization whose tax-exempt status is revoked under section 6033(j)(1) must apply to the IRS to obtain reinstatement of exempt status regardless of whether the organization was originally required apply for exemption.

Under section 508(a), an organization will not be treated as one described in section 501(c)(3) unless it gives notice to the Secretary that it is applying for recognition of such status. However, section 508(c)(1)(A) excepts churches, their integrated auxiliaries, and conventions or associations of churches from the section 508(a) notice requirement.

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[42] Section 6033(a)(3)(A)(ii) limits the exception to organizations with gross receipts normally not more than $5,000. Under authority granted in then section 6033(a)(2)(B), the IRS increased the amount to $25,000 effective for tax years ending on or after December 31, 1982. *See* IRS Announcement 82-8.

History of the annual return filing requirement

Tax-exempt organizations were not required to file annual information returns until 1943. But when, in 1943, Congress enacted a provision requiring exempt organizations to file annual information returns, it excepted religious organizations, educational organizations, and charitable organizations. Furthermore, there were no penalties for failure to file.[43]

Finding that "the primary purpose of [the information return] requirements is to provide the Internal Revenue Service with the information needed to enforce the tax laws," Congress, in 1969, concluded "that experience of these past two decades has indicated … that more information is needed on a more current basis for more organizations, and that this information must be made available to more public…."[44] Consequently, Congress enacted section 6033 of the Code as part of the Tax Reform Act of 1969 to require additional exempt organizations to file annual information returns.. The Act also instituted monetary penalties for failure to file. The original House bill, H.R. 13270, would have required every exempt organization to file an annual information return, "except where the Secretary … determines this to be unnecessary for efficient tax administration…. Administrative exceptions will be limited and are apt to take the form of permitting groups of affiliated organizations (such as chapters, lodges, etc., of national organizations) to file the equivalent of consolidated returns."[45]

The Senate Finance Committee introduced two exceptions to the annual filing requirement. First, it excepted churches, their integrated auxiliary organizations, and conventions or associations of churches. Second, it excepted any organization that normally has annual gross receipts of $5,000 or less.[46] The conference committee followed the Senate amendment, but also excepted from the filing requirement "any religious order with respect to its exclusively religious activities (but not including any educational, charitable, or other exempt activities which would serve as a basis of exemption under section 501(c)(3) if an organization which is not a religious organization is required to report with respect to such activities)."[47]

Constitutional considerations

Churches have no constitutional rights beyond those accorded any other type of religious organization. Unlike the tax law, the U.S. Constitution does not distinguish churches from other religious organizations. The word "church" does not appear in the Constitution; the First Amendment refers to "religion," not "church."

The Constitution does not require the government to exempt churches from federal income taxation or from filing tax and information returns. Although tax exemption for

[43] 1943 Revenue Act, ch. 63, 58 Stat. 21 36-37 (1943).
[44] H.R. Rep. No. 91-413, pt. 1, 36 (1969).
[45] *Id.*
[46] S. Rep. No. 91-552, 52 (1969).
[47] H.R. Rep. No. 91-782, 286 (1969).

religious institutions has been incorporated into American income tax statutes since the inception of the modern income tax in 1894, such exemption is a privilege, not a constitutional right.[48] "It has never been thought that freedom from taxation was a prerequisite attaching to the privileges of the First Amendment. The national government grants exemptions to ministers and churches because it wishes to do so, not because the Constitution compels."[49] "The collection and payment of … generally applicable tax … imposes no constitutionally significant burden on … religious practices and beliefs. The Free Exercise Clause accordingly does not *require* the State to grant [a religious organization] an exemption from … generally applicable … tax."[50]

The state, having exempted religious organizations from taxation, can require, in return, that they show their entitlement to exemption by conforming to the same financial reporting and tax audit provisions that apply to secular nonprofit organizations.[51] Requiring churches to file an annual information return does not offend either the Free Exercise Clause or the Establishment Clause. "The free exercise inquiry asks whether government has placed a substantial burden on the observation of a central religious belief or practice and, if so, whether a compelling governmental interest justifies the burden…. Even a substantial burden would be justified by the 'broad public interest in maintaining a sound tax system,' free of 'myriad exceptions flowing from a wide variety of religious beliefs.'"[52]

A sound tax system requires accountability from organizations that receive special tax benefits such as exemption from federal income tax. Testifying before the Oversight Subcommittee of the House Committee on Ways and Means at the 1987 hearing concerning television ministries ("1987 Hearing"), Michael Sanders, a practicing attorney and professor of exempt organization law at Georgetown University Law Center, remarked that "while I agree whole-heartedly with the propriety of certain special protections and procedures for religious organizations, we must also consider the government's compelling interest in assuring that tax exempt income is used for religious purposes as well as the public's expectation that this is being done."[53] Speaking at the same hearing, Roscoe L. Egger, Jr., a former Commissioner of Internal Revenue, argued that:

> Notwithstanding the fears expressed by some about the abridgment or impairment of their amendment rights … it is not fair to the people … who pay their taxes to not have reasonable assurance that the law is being applied

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[48] *See, e.g.,* Walz v. Tax Comm'n, 397 U.S. 664 (1970); Bob Jones Univ. v. United States, 461 U.S. 574 (1983); Texas Monthly, Inc. v. Bullock, 489 U.S. 1 (1989); Jimmy Swaggart Ministries v. Bd. of Equalization, 493 U.S. 378 (1990).
[49] Murdoch v. Pennsylvania, 319 U.S. 105, 130 (1943).
[50] Jimmy Swaggart Ministries, 493 U.S. at 392.
[51] Reka Potgieter Hoff, Financial Accountability of Churches for Federal Income Tax Purposes: Establishment or Free Exercise? 11 Va. Tax Rev. 71, 135 (1991).
[52] Hernandez v. Comm'r, 490 U.S. 680, 699-700 (1989) (quoting United States v. Lee, 455 U.S. 252, 260 (1982).
[53] Federal Tax Rules Applicable to Tax-Exempt Organizations Involving Television Ministries: Hearing Before Subcomm. on Oversight of the H. Comm. on Ways and Means, 100th Cong. 250 (1987)

> uniformly and evenhandedly…. They are entitled to know that the people who get special benefits under the tax laws … are entitled to those [benefits]…. This country benefits from a high rate of voluntary compliance with our tax laws. Voluntary compliance is the key element in our tax administration system. I believe Americans will continue to meet their tax obligations as long as they feel that they are being treated fairly and that others are also paying their fair share.[54]

To survive a constitutional challenge under the Establishment Clause, a state action must have a secular purpose, have as its principal or primary effect neither the advancement nor inhibition of religion, and must not create an excessive government entanglement with religion.[55] "A generally applicable tax has a secular purpose and neither advances nor inhibits religion, for the very essence of such a tax is that it is neutral and nondiscriminatory on questions of religious belief. Thus, whatever the precise contours of the Establishment Clause, its undisputed core values are not even remotely called into question by [a] generally applicable tax."[56] Furthermore, a "routine regulatory interaction" between the IRS and a religious institution [such as collecting information about the organization's services, products, and transactions] which involves no inquiries into religious doctrine, … no delegation of state power to a religious body, … and no 'detailed monitoring and close administrative contact' between secular and religious bodies … does not of itself violate the nonentanglement command."[57]

At the 1987 Hearing, Congressman Charles B. Rangel expressed frustration at the notion that constitutional considerations played any part in exempting churches from filing information returns:[58]

> Mr. Rangel: Do you see where filing an annual report by churches would be in violation of the constitutional right of separation of church and state?
>
> [IRS Commissioner] Mr. Gibbs: I have assumed … that was the reason – or certainly one of the prominent reasons – for specifically excluding them by statute in 1969.
>
> Mr. Rangel: Well, why do you reach that assumption? You know, it is only a congressional decision. Has any court said that you cannot put limitations on the privilege of tax exemption? We do it in unrelated [business income] taxes. We do it in lobbying. We do it in political affairs. We do it in FCC control. What in God's name could be even remotely considered a violation of the constitutional rights of churches to say that they should file an annual report as to how much money they got and what they did with it?

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[54] *Id.* at 240-242.
[55] Lemon v. Kurtzman, 403 U.S. 602, 612-13 (1971).
[56] Jimmy Swaggart Ministries, 493 U.S. at 394.
[57] Hernandez, 490 U.S. at 696-697.
[58] Federal Tax Rules Applicable to Tax-Exempt Organizations Involving Television Ministries: Hearing Before Subcomm. on Oversight of the H. Comm. on Ways and Means, 100th Cong. 54-55 (1987).

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> Mr. Gibbs: We are of the opinion that there is not a constitutional prohibition on requiring churches to file Form 990 information returns. For instance, currently religious organizations that are not churches are required to file Form 990, and churches, as well as other religious organizations are subject to detailed examinations of their books and records. We believe that both of these current law requirements are constitutional and, with respect to examinations of books and records, can be considered more intrusive than the filing of Form 990. [citations omitted]. The only constitutional problem we would foresee … would be if a statute differentiated between religious denominations in filing requirement in a manner that favored one denomination over another. [*See*, Bob Jones Univ. v. United States, 461 U.S. 574, 604 (footnote 30) (1983); Christian Echoes Nat'l Ministry v. United States, 470 F.2d 849, 857-859 (10th Cir. 1972)]

Discussion

As the federal agency delegated responsibility for the administration and enforcement of the tax laws, the IRS is responsible both for ensuring that an organization claiming to be exempt from federal income taxation under section 501(c)(3) meets the requirements of that section; specifically, that the organization is organized and operated exclusively for exempt purposes, that its net earnings do not inure to the benefit of private shareholders and individuals, that it does not engage in substantial amounts of lobbying, and that it does not intervene in political campaigns.

Thus, even though churches do not have a file an annual information return with the IRS, the IRS is still responsible for enforcing the tax laws that apply to them. Audits are IRS's primary method for enforcement of the tax laws. In determining which organizations to examine (and in determining whether the organizations selected for examination are complying with the tax laws), the IRS relies heavily on the information supplied in the Form 990. But because the Code exempts churches both from applying to the IRS for recognition of exemption and from filing annual returns, it is difficult for the IRS to discover and investigate abuses of section 501(c)(3) status by churches that do not choose to seek recognition of tax-exempt status or to file annual returns.

Currently, anyone can set up an organization, call the organization a church, solicit tax-deductible contributions, and – unless the organization voluntarily applies for recognition of tax-exempt status or files annual returns – that organization will be invisible to the IRS and operate virtually without government oversight because no state requires religious organizations to register and file annual financial reports with the state attorney general.[59]

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[59] Marion R. Fremont-Smith, The Search for Greater Accountability of Nonprofit Organizations: Recent Legal Developments and Proposals for Change, 76 Fordham L. Rev. 609, 628 (2007).

Because churches do not even have to notify the IRS when they form, anyone can set up an entity to receive donations, claim church status when asked, and then shut down quickly. This is easier than ever to do today through the internet. Two of the entities referred to the Committee for investigation were a mail order church and a website set up by a woman practicing voodoo. Both were referred to the Committee because of solicitation concerns.

While the word "church" might evoke the image of a place "far from the madding crowd," in reality church institutions come in all varieties and all are buffeted by the same concerns that shake secular society and are vulnerable to the same temptations and sins that visit civil institutions. The label "church" does not guarantee that the organization to which it attaches is operating exclusively (or even slightly) for religious purpose.

In addition, the average person may not see a difference between a charitable religious organization and a church. For example, we received inquires asking why the Billy Graham Evangelistic Association and the Trinity Broadcasting Network filed a Form 990 but the media-based organizations we reviewed did not.

In the case of the Church of Scientology, an organization for which we received multiple investigation requests, it might appear that obtaining church status is a result of having the financial resources to battle the IRS. On Oct. 1, 1993, the IRS entered into a closing agreement with that organization under which the IRS agreed, among other things, to recognize the Church of Scientology International (and its subordinate ministries), Scientology Missions International (and its subordinate ministries), and the Church of Spiritual Technology ("CST"), among others, as exempt under section 501(c)(3), and to classify them as "churches" within the meaning of section 170(b)(1)(A)(i), thereby excepting them from the requirement to file annual information returns under section 6033. The IRS also determined that numerous other Scientology-related organizations "are church-affiliated organizations that need not file annual Forms 990."[60] The details of the agreement were kept secret until reported in the Wall Street Journal in December 1997.[61]

Scientology is not a "conventional" church, and had not been treated as such by the IRS for many years. But with the 1993 closing agreement, the IRS did an "about face" and effectively relinquished earlier court victories, including one just a year earlier over Scientology's CST. For in a 1992 decision, the U.S. Court of Claims sided with the IRS against CST, holding that CST had not shown itself to be exempt under section 501(c)(3). In the court opinion dismissing the CST's complaint against the government, Judge Bruggink observes that "procedures for handling money in Scientology are remarkably complex," and says that any attempt "to describe Scientology's Byzantine management structure and financial arrangements [is] difficult due to the proliferation of

[60] Closing Agreement on Final Determination Covering Specific Matters, § III, at 97 Tax Notes Today 251-24.
[61] Douglas Frantz, Tax Agency Hints at Inquiry on Leak on Scientologists, N.Y. Times, Jan. 1, 1998, at A13.

entities and accounts and the overlap of personnel." The Court remarks on Scientology's "scriptural emphasis on taking in money as well as passive resistance to tax inquiries," and notes that "other courts have encountered this same phenomenon (citations omitted)."[62] Finding that "CST is linked by a cat's cradle of connection … to the rest of Scientology … coupled with the commercial character of much of Scientology [with its] virtually incomprehensible financial procedures, its scripturally-based hostility to taxation … and [CST's] enormous potential for both accumulating wealth and bestowing shelter from taxation," the Court concludes that "the inference is inescapable that CST is merely the latest incarnation of the on-going effort of Scientology as a whole to shelter income from taxation."[63]

The IRS also relinquished an earlier victory in the Supreme Court which, in 1989, sided with the IRS in holding that fixed payments to the Church of Scientology in return for services known as "auditing" and "training" were not charitable deductions under section 170(c) of the Code.[64] But under the 1993 closing agreement, the IRS agreed not to contest the deductibility of such fixed payments.[65]

Lawrence Gibbs, who, as IRS Commissioner, had testified at the 1987 Hearings, called the IRS's decision to recognize Scientology as a tax-exempt church "very surprising…. When you have as much litigation over as much time, with the general uniformity of results that the Service had with Scientology, it is surprising to have the ultimate decision be favorable. It was even more surprising that the Service made the decision without full disclosure, in light of the prior background."[66]

"Prior background" refers to a sixteen year period in which the IRS refused to recognize Scientology's tax-exempt status and during which "litigation involving Scientology organizations has often been protracted and combative."[67] Though it recognized the Church of Scientology of California as tax-exempt on 1954, the IRS revoked the church's exemption in 1967. In 1984, the Tax Court sided with the IRS, holding that the church was not tax-exempt because it had a substantial commercial purpose, its net earnings had improperly benefitted key Scientology officials, and it had the illegal purpose of conspiring to impede the IRS from collecting taxes. The court found that, "in pursuit of the conspiracy, [the church had] filed false tax returns, burglarized IRS offices, stole IRS documents, and harassed, delayed, and obstructed IRS agents who tried to audit Church records."[68]

It has been reported that Scientologists waged a similar campaign of harassment and intimidation against the IRS just before the IRS's "stunning reversal" of position on

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62 Church of Scientology v. United States, 26 Cl. Ct. 713, 733-34 (1992).
63 *Id.* at 736-37.
64 Hernandez v. Comm'r, 490 U.S. 680 (1989).
65 Closing Agreement on Final Determination Covering Specific Matters, § VII, at 97 Tax Notes Today 251-24.
66 Douglas Frantz, Taxes and Tactics: Behind an I.R.S. Reversal – A Special Report; Scientology's Puzzling Journey From Tax Rebel to Tax Exempt, N.Y. Times, Mar. 9, 1997, at § 1, p. 1;
67 Church of Scientology v. United States, 26 Cl. Ct. 713, 727 (1992).
68 Church of Scientology of California v. Comm'r, 83 T.C. 381, 505 (1984).

Scientology's tax-exempt status in 1993. After conducting more than 30 interviews and reviewing thousands of pages of public and internal church records, the New York Times reported that the IRS's closing agreement with Scientology "followed a series of unusual internal I.R.S. actions that came after an extraordinary campaign orchestrated by Scientology against the agency and people who work there;" a campaign in which "Scientology's lawyers hired private investigators to dig into the private lives of I.R.S. officials and to conduct surveillance operations to uncover potential vulnerabilities…. The church also financed an organization of I.R.S. whistleblowers that attacked the agency publicly."[69]

The "unusual internal I.R.S. actions" referred to in the report began when Scientology's leader, David Miscavige, was granted an impromptu (and, therefore, highly irregular) meeting with the IRS Commissioner, after which the IRS created a special commission to negotiate a settlement with Scientology outside normal agency procedures. After the commission decided that all Scientology entities should be exempt from taxes, IRS tax law specialists reviewing the exemption applications of individual Scientology organizations were instructed to "ignore substantive tax issues," [70] such as whether the organization was engaged in too much commercial activity or whether its activities provided undue private benefit to its leaders, issues which, if considered, might have argued against tax-exempt status.

A recent series of special reports in the St. Petersburg Times (Florida)[71] on abusive behavior by Scientology leaders tells how Scientology waged a war of attrition against the IRS in the late 1980s, filing 200 lawsuits against the IRS, seeking documents by which to prove IRS harassment, and challenging the IRS's refusal to grant tax exemptions to church entities. As part of the campaign, "some 2,300 individual Scientologists also sued the [IRS], demanding tax deductions for their contributions."[72] Under the 1993 closing agreement, the Church "agreed to drop more than 2,000 lawsuits against the tax agency and present and former tax officials,"[73] and to "stop assisting people or groups suing the IRS…."[74] The Times reports also show how the Church of Scientology continues to "[use] intimidation and brutality to control its employees, places financial ambition above spiritual service to its members, and stops at nothing to undermine its critics."[75]

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[69] Frantz, Taxes and Tactics: Behind an I.R.S. Reversal – A Special Report; Scientology's Puzzling Journey From Tax Rebel to Tax Exempt, N.Y. Times, Mar. 9, 1997, at § 1, p. 1.
[70] *Id*.
[71] *See* Joe Childs & Thomas C. Tobin, The Truth Rundown, St. Petersburg Times (Florida), June 21, 2009, at 1A; Thomas Tobin & Joe Childs, Death in Slow Motion, St. Petersburg Times (Florida), June 22, 2009, at 1A.; Thomas Tobin & Joe Childs, Ecclesiastical Justice, St. Petersburg Times (Florida), June 23, 2009, at 1A.
[72] Joe Childs & Thomas C. Tobin, The Truth Rundown, St. Petersburg Times (Florida), June 21, 2009, at 1A.
[73] Douglas Frantz, Tax Agency Hints at Inquiry on Leak on Scientologists, N.Y. Times, Jan. 1, 1998, at A13.
[74] Edward P. Jones, Details of 1993 IRS, Scientology Settlement Disclosed, 19 Exempt Org. Tax Rev. 305 (1998).
[75] The Abuse Behind Scientology's Façade, St. Petersburg Times (Florida), June 24, 2009, at 10A.

Considering the history of enmity between Scientology and the IRS, the unusual circumstances and irregular processes that brought about a closing agreement that constituted a complete reversal of previous IRS determinations concerning Scientology-related organizations—determinations that had been affirmed by numerous courts, and the secrecy surrounding the particulars of the agreement, "suspicions that the exemption finally was granted … because of relentless intimidation and pressure rather than an interpretation of the tax code" are not surprising.[76] Once the particulars of the agreement were publicized, some tax experts expressed concern that the IRS merely wanted "to buy peace from the Scientologists."[77]

The Church of Scientology (and many of its multitudinous subordinate organizations) – which courts have found to have a "Byzantine management structure", a commercial character, and incomprehensible financial procedures", and which secured its tax-exempt (and church) status, in part it seems, by wearing down the IRS through an aggressive campaign of harassing litigation, culminating in a closing agreement arrived at through "unusual internal I.R.S. actions", is now classified as a church and so does not file a Form 990.

As churches and ministries grow in size – in terms of members, income, and value of assets – the need for accountability becomes ever greater. Concern over a lack of transparency and accountability was raised repeatedly during the 1987 Hearing. Testifying before the committee, former IRS Commissioner Egger observed that "while I believe there is an overwhelming consensus supporting the basic tax treatment extended to churches, it is clear that these tax benefits have attracted the attention of unscrupulous and fraudulent operators…."[78]

Government officials testifying at the 1987 Hearing quickly focused on the church exception to the annual return filing requirement as one of the main reasons that abuses at some TV ministries go undetected. The Assistant Treasury Secretary for Tax Policy, O. Donaldson Chapoton, testified that "the absence of the kind of information routinely obtained for other tax-exempt organizations makes it difficult for the IRS to achieve effective enforcement of the laws applicable to organizations that claim to be churches…. Exempting churches from reporting requirements and placing restrictions on IRS audit activities reduce the ability of the IRS to administer and enforce the law."[79] IRS Commissioner Gibbs added that "the fundamental issues for tax administration … are the appropriate degree of public accountability by religious organizations soliciting public contributions and the ability of the Service to audit these organizations to ensure compliance with the tax laws…. [U]nder current law, the Service is limited by the information it … receives from churches and the restrictions on our ability to audit churches. The Service, therefore, is unable to assure the same level of compliance with

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[76] *Id.*
[77] Edward P. Jones, Details of 1993 IRS, Scientology Settlement Disclosed, 19 Exempt Org. Tax Rev. 305 (1998).

[78] Federal Tax Rules Applicable to Tax-Exempt Organizations Involving Television Ministries: Hearing Before Subcomm. on Oversight of the H. Comm. on Ways and Means, 100th Cong. 241 (1987).
[79] *Id.* at 14-15.

the tax law by [churches] as is the case with other tax-exempt organizations…."[80] "Since we have no information in the way of an initial application or annual returns, this largely means that it is a reactive type of thing. It is only after it comes to our attention in a credible way from the public that we can even begin an audit."[81] Law professor Michael Sanders remarked that because churches need not file information returns, the IRS "is in a situation where they are being embarrassed because everyone assumes that they are carrying out their responsibility to the public and the Congress when in fact they do not know about many of the problems because they do not have the facts."[82]

Congressman Rangel was particularly disturbed to learn that the government was ignorant of the charitable dollars raised by churches:

> Mr. Rangel: From what I understand from the testimony of this panel, any person or organization could declare themselves a church, enjoy tax exemption, and you would have no way of knowing.
>
> Secretary Chapoton: That is correct.
>
> Commissioner Gibbs: Indeed, that has been one of the principal problems in the mail order ministry area.
>
> Mr. Rangel: It would seem to me that for any amounts of monies that could be solicited publicly or privately by these churches, you would have no way of knowing whether there is any tax abuse or violation of any civil or criminal laws.
>
> Commissioner Gibbs: It is difficult unless it was somehow brought to our attention, because if the church does not file an application or an annual form [990], we may very well have difficulty in determining that.
>
> Mr. Rangel: What you are saying is that people can solicit millions of dollars and you have no way to account to the federal government.
>
> Commissioner Gibbs: Yes, sir. [83]

Congressman Dorgan was at a loss to understand how the government and the public could learn about dubious fundraising practices if churches are not required to file annual information returns. Addressing the Rev. D. James Kennedy of Coral Ridge Ministries and Coral Ridge Presbyterian Church, he posited the following scenario:

> Mr. Dorgan: Assume for a moment that I decided tomorrow that I am a minister…. In my ministry, I am going to go on television, preach, and ask for money. I am going to get some money and I am going to put it in my pocket. I

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[80] *Id.* at 33.
[81] *Id*. at 41.
[82] *Id*. at 247.
[83] *Id.* at 54.

> am going to use it for my good, to enhance my lifestyle, spend it the way I want to spend it on trips and vacations and so on. What would you think would be the remedy for that kind of behavior…?
>
> the Rev. Kennedy: I would think that if a person is going to give money to something, that they have … a responsibility to learn where it is going.
>
> Mr. Dorgan: How would they do that sir? … For example, the PTL; I understand the local newspaper was trying to find out for five years what was happening to the money. How would the public understand what I am doing with the money if I am not required to submit a [Form] 990 report. How could they find out?
>
> the Rev. Kennedy: They could write and ask for a financial statement. [84]

The Rev. Jerry Falwell, representing the Old Time Gospel Hour, while conceding the value of the information reported on Form 990, was hesitant to have Congress impose a filing requirement on churches, saying that "I wish all churches voluntarily would file a [Form] 990 or at least voluntarily make their financials public, willingly, without being asked. But I would oppose the churches being compelled to do so because of excessive entanglement."[85]

But requiring churches to abide by the same filing rules as other tax-exempt organizations is less likely to result in government entanglement than carving out an exception for churches. Because the Code does not define the word "church," it cedes to the IRS the job of setting the criteria for determining which organizations are churches and which are not. The Rev. Oral Roberts thought that the IRS should not be the judge of whether an organization qualifies as a church:

> I did not know exactly if you were going to discuss religion, because if we did, I was going to ask you can you define a "church." I think the IRS has a real problem because they will say to one group you are a church, and to another group, you are not. I really think the Congress should address that.[86]
>
> It seems to me that our [Oral Roberts] Ministry is a church in every sense of the word, yet the Internal Revenue Service says we are not a church.[87]

Echoing Oral Roberts' concern, the Court of Federal Claims, in a recent case, said it is "uncomfortable with criteria used by the IRS for determination of the church status of religious organizations," finding that those criteria "are time-conditioned and reflect institutional characteristics that no longer capture the variety of American religions and religious institutions in the twenty-first century. The regime appears to favor some forms of religious expression over others in a manner in which, if not

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[84] *Id.* at 72.
[85] *Id*. at 90.
[86] *Id*. at 161.
[87] *Id*. at 153.

inconsistent with the letter of the Constitution, the court finds troubling when considered in light of the constitutional protections of the Establishment and Free Exercise Clauses."[88]

At the 1987 Hearing, Oral Roberts also raised the issue of unequal treatment between churches and non-church religious organizations.

> It appears to me that not all religious organizations are treated equally under existing tax laws…. Although I do not claim to understand the legal intricacies of how a religious organization and a church are different, I do know that the Oral Roberts organizations are required to file … yearly informational [Form] 990 returns. These reports disclose our contributions and expenses among other things, and are available to anyone. Other churches are not required to file these reports and that, again, is something I do not understand. Certainly I am not opposed to filing these reports, but I feel very strongly that these laws should be uniformly applied. If the Oral Roberts Ministry is required to file these reports, then should not the Catholics, the Mormons, the Baptists, the Methodists, and all other churches also be required to file these same reports? … It seems to me that either our existing tax laws are not being uniformly applied to all churches such as ours, or the tax laws should be changed to remedy this discrepancy. Should not all churches be treated equally under the law? Organizations, whether religious or secular, which raise contributions from the public must be accountable. Some changes in the law to insure this accountability as well as uniform enforcement may be needed.[89]

It is telling that the witnesses at the 1987 Hearing representing religious organizations required to file information returns were uniformly supportive of the Form 990 filing requirement. Oral Roberts did not see self-policing by a voluntary accreditation agency like the Evangelical Council for Financial Accountability (ECFA) as an adequate substitute to filing reports with the IRS.[90] (Note that Oral Roberts University became an ECFA member in 2009). Asked whether his ministry was a member of ECFA, the Rev. Roberts responded:

> We were invited to be a member of that … but we believed there was no teeth in it; and I think that has been proved by the PTL thing. Ours was so much stronger; our auditing procedures and our filing of the [Form] 990 every year…. We have a corps of auditors…. Anybody in the United States can get a copy of our [Form] 990 report at any time, by writing the IRS; it is available to the media, to everybody in America…. Why wouldn't all file a [Form] 990 – why? I have no

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[88] Found. of Human Understanding v. United States, No. 1:04-cv-01441 (Fed. Cl. e-filed July 21, 2009).
[89] Federal Tax Rules Applicable to Tax-Exempt Organizations Involving Television Ministries: Hearing Before Subcomm. on Oversight of the H. Comm. on Ways and Means, 100th Cong. 153 (1987).
[90] Information on the ECFA Website (http://www.ecfa.org/Content/WhatIsECFA.aspx) describes ECFA as "an accreditation agency dedicated to helping Christian ministries earn the public's trust through adherence to *Seven Standards of Responsible Stewardship.* Founded in 1979, ECFA provides accreditation to leading Christian nonprofit organizations that faithfully demonstrate compliance with established standards for financial accountability, fund-raising, and board governance."

> objection at all. In fact, if it will help, if there is a loss of confidence, let us do something about it.[91]

Asked about the scandal surrounding televangelist Jim Bakker and the PTL, the Rev. Roberts said:

> Well, if they file a [Form] 990 like we do and have the accountants and accuracy, there is no way that could have happened in my organization, so I do not understand it – how could it have happened?[92]

The Rev. Ben Armstrong, representing the National Religious Broadcasters, agreed that, regardless of whether a religious broadcasting organization is a member of an ethical and financial accreditation body like the NRB, there is still a need for the IRS to determine whether such organization is in compliance with the Tax Code.[93] And Gordon D. Loux, chairman of the board of the Evangelical Council for Financial Accountability, told the Subcommittee that "we would feel that the IRS Form 990 is a minimal requirement that ought to be met by those that are operating in the public service."[94] (Note that the ECFA clarified Loux's position in a 2009 letter to Senator Grassley.) The Rev. Larry Jones of Larry Jones International Ministries; Feed the Children and the Rev. Paul F. Crouch of Trinity Broadcasting Network both said that they had "no problem" with filing the Form 990, with the Rev. Crouch citing the Apostle Paul's admonishment to "provide all things honest in the sight of all men."[95]

All six media-based organizations we reviewed are classified as churches and so do not file 990s. With respect to the four that did not comply with the Committee's requests, as indicated in the separate summary for each church, there are multiple for-profit and non-profit entities related to each church. Multiple "assumed" or "doing business as" names were also used. For example, we found at least 21 "assumed names" registered with the State of Texas for Eagle Mountain International Church (also known as Kenneth Copeland Ministries). These included record companies and recording studies. This raises the question of whether church status is being gamed to shield such activities of a tax-exempt entity from public scrutiny. This also raises the question of whether Congress intended for an organization to be exempt from filing a Form 990 if its activities were deemed be regular, i.e., non-church, charitable activities or the activities would be subject to income taxes if not deemed to be charitable.

A Form 990 generally was not found on Guidestar.org for the non-profit entities found to be associated with the churches. As a result, we assumed that some of these entities

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[91] Federal Tax Rules Applicable to Tax-Exempt Organizations Involving Television Ministries: Hearing Before Subcomm. on Oversight of the H. Comm. on Ways and Means, 100th Cong. 158-159 (1987). Oral Roberts University became an accredited member of ECFA on March 13, 2009 (http://www.ecfa.org/PressReleaseDisplay.aspx?PressReleaseID=194).
[92] Federal Tax Rules Applicable to Tax-Exempt Organizations Involving Television Ministries: Hearing Before Subcomm. on Oversight of the H. Comm. on Ways and Means, 100th Cong. 162 (1987).
[93] *Id*. at 234-235.
[94] *Id.* at 235.
[95] *Id.* at 177, 198.

are deemed “integrated auxiliaries” of the church and therefore exempt from filing the Form 990. As a result, we are concerned that the “integrated auxiliary” classification is also being gamed.

For example, New Birth Missionary Baptist Church (NBMBC), Eddie Long’s church, listed, in its response to the Committee, LongFellows Youth Academy (LYFA) as an integrated auxiliary. Alumni of LYFA programs filed suit against Long alleging sexual misconduct when they were minors. According to LFYA’s website[96], the organization was established in 2004 by Bishop Eddie L. Long. No address or phone number is provided under the “Contact” section of the website.

On its website, LYFA’s states its vision as: “Training our youth to Love, Live, and Lead.” A mission statement or goals or objectives are not provided. A section of the website titled “The Facts and Statistics” indicates that LYFA provides college scholarships and education in areas such as physical training and conflict resolution.

While LFYA’s does solicit donations on its website, the website does not contain any information regarding LYFA’s tax status. Donations are processed through PayPal. On LYFA’s website, NBMBC is listed under a section titled, “Lasting Legacy Wall”, which appears to be a list of sponsors.

LYFA is listed on Guidestar.org with an address of 6400 Woodrow Road, c/o Frederick Folson, Lithonia, GA 30038 but a Form 990 is not available. Frederick Folson is the Chief Financial Officer (CFO) of New Birth Missionary Baptist Church (NBMBC). As s result, staff presumes that LYFA is not filing a Form 990 because it is taking advantage of the integrated auxiliary exception. If it wasn’t for LYFA’s affiliation with NBMBC, LYFA’s tax-exemption would derive from its educational activities – not church activities – and would therefore have had to file a Form 990. This raises the question of whether these type of organizations is what Congress envisioned when exempting integrated auxiliaries from filing a Form 990.

We also have concerns about organizations dissolving charitable organizations into a church so those activities would not be subject to public scrutiny. For example, we found that Bishop Eddie Long dissolved Bishop Eddie L. Long Ministries, Inc. (BELL) in 2002 and transferred BELL’s assets to Long’s church, the New Birth Missionary Baptist Church. The benefit of not having to file a 990 that comes with church status just makes it more difficult for the IRS review and audit activities that otherwise would be reported on a Form 990. The lack of IRS oversight is not as worrisome when there is oversight by an independent third party, such as the ECFA, or even denominational oversight.

A 2005 study of megachurches in the United States found that between 35 and 40 percent of those surveyed claimed to be nondenominational, and that many of the rest

[96] http://www.longfellowyouthacademy.org (last visited on January 2, 2011)

downplay their denominational affiliation.[97] Creflo Dollar's World Changers Church International, Randy White's Without Walls International Church, and the Benny Hinn Ministries are all characterized as "nondenominational" in a database of megachurches maintained by the Hartford Institute for Religious Research.[98]

According to a report in the Atlanta Journal and Constitution:

> Some pastors take advantage of a lack of denominational accountability to enrich themselves, said J. Lee Grady, editor of Charisma, a national magazine that covers charismatic churches…. "There are many independent churches out there today that are accountable to no one," he said. Their board structures are controlled by a few insiders and no one can bring correction.[99]

A Washington Post article about Star Scott, the pastor of Calvary Temple in Sterling, Virginia, reports that Scott "led Calvary to leave the Assemblies of God denomination and become independent…. Scott's decision to leave the Assemblies of God removed a level of financial oversight, and he eliminated boards and public votes, former members said. Calvary's constitution calls for finances to be administered 'by the presiding elder and/or recognized Apostle.' Scott holds both positions, according to church documents. The constitution also says that if the church closes, all property will be controlled by the apostle." Experts with the Assemblies of God called Calvary's lack of transparency "unusual." "'It's not the norm within the Assemblies of God for the pastor to be able to determine everything," said Ron Hall, chairman of church ministries and Valley Forge Christian College and a longtime Assemblies minister. 'This is a prime example of someone who wants ultimate control. I would think there would be serious flags.'"[100] In July 2009, it was reported that "the IRS is investigating [Scott's] control of church finances, which include $8.5 million in church real estate and hundreds of thousands of dollars' worth of vehicles that he and his wife use in a "racing ministry."[101]

This lack of governmental, independent or denominational oversight is troubling when considering that churches can reach the size of large taxable corporations, control numerous taxable and non-taxable subsidiaries, and bestow Wall Street-size benefits on their ministers. The 2005 megachurch survey found that there were 1,210 megachurches (i.e., Protestant congregations that draw 2,000 or more attendees in a typical weekend) in the United States, nearly double the number that existed five years

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[97] Scott Thumma et al., Megachurches Today 2005: Summary of Research Findings 4-5 (2005), *available at* http://hirr.hartsem.edu/megachurch/megastoday2005_summaryreport.html.
[98] Database of Megachurches in the U.S, http://hirr.hartsem.edu/megachurch/database.html.
[99] John Blake, Bishop's Charity Generous to Bishop: New Birth's Long Received $3 Million, Atlanta J.-Const., Aug. 28, 2005, at A1.
[100] Michelle Boorstein, In Va., a Powerful and Polarizing Pastor; A Loudoun Minister Inspires Loyalty From Followers, Anger From Ex-Members With Torn Lives and Moral Pain, Wash. Post, Nov. 16, 2008, at A01.
[101] Michelle Boorstein, IRS Is Investigating Finances, Pastor of Sterling Church Says, Wash. Post, July 21, 2009, at B03.

earlier.[102] The survey also found that average annual expenditure of a megachurch in 2005 was $5.6 million.[103] A follow-up study conducted in 2008 found that average megachurch income in 2008 was $6.5 million. Generally, fifty percent of income went to salaries, a quarter to buildings, and a quarter to missions and programs.[104]

Creflo Dollar's World Changers Church International and Eddie Long's New Birth Missionary Baptist Church place among the 20 largest of the 1,366 megachurches listed in the Hartford Institute's database. An article in an Atlanta newspaper reports that "[Bishop Eddie Long's] New Birth Missionary Baptist Church, Atlanta's largest congregation has a membership of about 25,000…. Its Lithonia campus sits on 250 acres, a tract big enough to hold six Mall of Georgia shopping centers."[105] The campus encloses a "$50 million, 10,000-seat sanctuary, a Christian school of more than 200 students, bookstore, computer lab, and the fully equipped Samson Fitness Center with racquetball and basketball courts and saunas."[106]

Joyce Meyer Ministries (JMM), which posts its annual reports on its website, reports 2008 revenues of $112 million (including $93.3 million in contributions), and total assets on December 31, 2008, of $79.7 million. (Note that JMM became a member of the ECFA in March 2009). The 2006 audited financial statements of Without Walls International Church show revenue for calendar year 2006 of $39.9 million, and total assets on December 31, 2006, of $39.3 million.[107] The audited financial statements of Benny Hinn Ministries for 2006, which were provided to the Finance Committee but are not posted on the Ministries' web site, show total revenue and support of $97.93 million. A story written for CBS News reports Kenneth Copeland as saying that his ministry "takes in about $100 million a year in revenue."[108]

Creflo Dollar's World Changer's Church does not make its financial statements public. An article in an Atlanta newspaper states that the church claims a membership of 30,000, and that services are conducted in an $18 million, 8,500 seat "World Dome."[109] According to its website, the Church currently operates satellite churches in Brooklyn

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[102] Scott Thumma et al., Megachurches Today 2005: Summary of Research Findings 1 (2005), *available at* http://hirr.hartsem.edu/megachurch/megastoday2005_summaryreport.html.
[103] *Id.* at 25.
[104] Scott Thumma and Warren Bird, Changes in American Megachurches: Tracing Eight Years of Growth and Innovation in the Nation's Largest-Attendance Congregations 4-5 (2008), *available at* http://hirr.hartsem.edu/megachurch/megastoday2008_summaryreport.html.
[105] John Blake, Metro Atlanta's Megachurches: Supersize: Today's Pastors feed Multitudes With More Than Worship, Atlanta J.-Const., Apr. 20, 2003, at 1.
[106] Christopher Quinn, Figures Released by Megachurch, Atlanta J.-Const., Nov. 11, 2007, at E1.
[107] The 2006 audited financial statements of Without Walls International Church (WWIC) were once available from the website of Paula White Ministries at http://www.paulawhite.org/images/Documents/auditfinancials.pdf, but that URL was dysfunctional on 07/27/2009; the websites of WWIC and Paula White Ministries as they appeared on 07/27/2009 have no links to any financial statements.
[108] Laura Strickler, Church Bylaws Show "Control Freak" Televangelist, at http://www.cbsnews.com/stories/2008/04/21/cbsnews_investigates/main4033537.shtml
[109] Christopher Quinn, Figures Released by Megachurch, Atlanta J.-Const., Nov. 11, 2007, at E1.

and Queens, NY, and has plans to open an additional 17 satellite churches around the country. Dollar's goal is to have 500 satellite churches.[110]

Changing the annual filing requirements to address these concerns poses significant challenges, including constitutional ones. Eliminating the church exception would most likely withstand constitutional scrutiny. However, such a requirement would unnecessarily burden the overwhelming majority of churches, particularly those that are already financially challenged. Such a requirement would also needlessly burden the IRS's Exempt Organizations Office which many believe already doesn't have enough resources. Moreover, eliminating the church exception to the filing requirements would also be contrary to Congress's intent. Congress sent a strong signal with the enactment of section 7611, also known as the Church Audit Procedures Act, and the 2002 amendments to the parsonage allowance provision, that it expects minimal interference in church operations from the IRS. As a result, we do not recommend completely eliminating the church exception to the filing requirements, i.e., we do not recommend requiring every church to file a Form 990.

However, we did discuss limiting the filing exception in various ways. Requiring some version of the Form 990-N, "e-postcard", which was implemented in 2007, was one idea. It only requires basic information such as federal employer identification number, name, address, and a contact person for the organization.

We considered limiting the exception to churches that provided members with some voting rights. For example, at one Baptist church in Virginia, members are entitled to vote on the annual budget, the calling and dismissing of the pastor, the recommendation of a trustee or deacon. Members are entitled to see the budget before voting and can ask questions pertaining to any item on the budget, including salaries and balances in bank accounts. All internal groups created and empowered by the church shall be accountable to the church, unless otherwise specified by church action; this includes but is not limited to the Trustee Board and the Deacon Board.

We found another example from a Community church.

The Congregation will

A. Elect members to fill vacancies on the Board of Trustees and approve the budget for the ensuing year by a majority vote.
B. Call or dismiss the pastor in accordance with the pertinent denominational policy.
C. Approve or disapprove any proposed unbudgeted expenditures that would exceed ten per cent of the total current budget.
D. Hold an annual meeting during the month of January when it will receive reports of all ministry teams, officers, and ministers for the year just ended.

[110] http://www.creflodollarministries.org/SatelliteChurch/SatelliteChurch.html

E. Hold special meetings as needed. A quorum at congregational meetings will be the President of the Board of Trustees or the President's designee and ten per cent of active membership. Voting by proxy is not allowed.[111]

A Unitarian Universalist Congregation provides the following**.**
Membership
Membership is available to all regardless of race, age, gender, sexual orientation, ethnic and national origin, social status, economic status, marital status or disability.
At the annual business meeting, members vote on the budget and conduct other business.
Members are entitled to vote on the following: buying and selling of real property, calling and dismissing a minister, amending or replacing bylaws[112]

We also considered limiting the filing exception for those subject to denominational oversight or oversight by an independent third party, such as the ECFA. We also considered requiring churches to publicly disclose only certain information, such as related entities and policies and procedures. Finally, we considered eliminating the integrated auxiliary exception.

However, the constitutional law analysis required to consider these limitations was beyond our expertise. We also realize that ECFA may be the only "accreditation" organization that exists for religious organizations and its Christian-centered approach may deter non-Christian churches from joining ECFA.

Issues for Consideration

Should new entities claiming church status at least be required to notify the IRS of its intent to claim church status?

Alternatively, should new entities claiming church status only be required to notify the IRS of church status if they intend to solicit contributions from the public?

Would any of the limitations to the filing exception discussed above, or requiring an "e-postcard" for certain organizations, be feasible without violating constitutional principles?

What role could the proposed Advisory Committee on Churches and Religious Organizations play in assisting the IRS with examination selection criteria and education and outreach efforts?

Could the IRS consider denominational or independent third party oversight when determining criteria for selecting churches for audit?

[111] http://www.flagstafffederatedchurch.org/archives/minutes/BOT%20Minutes%2003232010.pdf
[112] http://www.mpuuc.org/aboutmpuuc/bylaws.pdf

Regardless of whether the filing requirements are unchanged, could ECFA's model be replicated for other churches and religious organizations?

4) Church Tax Inquiries and Section 4958 Excise Taxes

Present law

Section 7611 prohibits the IRS from conducting a church tax inquiry or church tax examination unless certain procedural prerequisites are met. Before the IRS can conduct a church tax inquiry, an appropriate high-level Treasury official must reasonably believe, on the basis of facts and circumstances recorded in writing, that the church in question may not be exempt or may be carrying on an unrelated trade or business,[113] and the church must be given written notice of the beginning of such inquiry.[114] A "church tax inquiry" is defined as any inquiry to a church (other than an examination) to serve as a basis for determining whether a church is exempt from tax under section 501(a) by reason of its status as a church, or is carrying on an unrelated trade or business or is otherwise engaged in activities which may be subject to federal taxation.[115] The statute contains procedural provisions designed to hasten the determination of church tax liabilities, including a requirement that church tax inquiries and examinations generally be completed no later than two years after the date of the examination notice.[116]

Section 7611(i)(2) states that the section 7611 does not apply to any inquiry or examination relating to the tax liability of any person other than a church. Similarly, Treas. Reg. 301.7611-1, Q&A-6, states that the church inquiry and examination procedures described in section 7611 do not apply to any inquiry or examination relating to the tax liability of any person other than a church. However, Treas. Reg. 53.4958-8(b) states that the church audit procedures of section 7611 must be followed by the IRS in initiating and conducting any inquiry or examination into whether an excess benefit transaction has occurred between a church and a disqualified person even though no tax liability would be imposed on the church itself under section 4958.

Discussion

Section 7611 was enacted as part of the Deficit Reduction Act of 1984. According to the Joint Committee on Taxation's explanation of the 1984 Act, Congress, in putting restrictions on church tax inquiries and examinations, "recognized that an increasing number of taxpayers had … utilized the church form primarily as a tax-avoidance device. Congress believed that the IRS must retain an unhindered ability to pursue

[113] I.R.C. § 7611(a)(2).
[114] I.R.C. § 7611(a)(3).
[115] I.R.C. § 7611(h)(2).
[116] I.R.C. § 7611(c)(1).

individuals who use the church form in this manner."[117] In describing the scope of the church tax inquiry and examination procedures, the JCT explanation says that:

> Congress intended that inquiries or examinations that relate primarily to the tax status or liability of persons other than the church … rather than the tax status or liability of the church itself, not be subject to the church tax inquiry and examination procedures. These inquiries or examinations may include … (1) inquiries or examinations regarding the inurement of church funds to a particular individual or to another organization, which inurement may result in the denial of all or part of such individual's or organization's deduction for contributions to the church, (2) inquiries or examinations regarding the assignment of income or services or excessive contributions to a church, and (3) inquiries or examinations regarding a vow of poverty by an individual or individuals followed by a transfer of property or an assignment of income or services to the church. The IRS may inquire of a church regarding these matters without being considered to have commenced a church tax inquiry and may proceed to examine church records relating to these issues (including enforcement of a summons for access to such records) without following the requirements applicable to church tax examinations, subject to the general Code rules regarding examinations of taxpayer books and records…. In an inurement case, the IRS may request information or examine church records regarding amounts of money, property, or services transferred to the individual or individuals in question (including wages, loans, or noncontractual transfers), the use of church funds for personal expenses, or other similar matters, outside of the church tax inquiry and examination procedures.[118]

Since section 4958, imposes tax only on the disqualified person who is provided an excess benefit (and on any organization manager who knowingly participates in an excess benefit transaction), but not on the organization that provides the excess benefit, an IRS inquiry or examination into someone's tax liability under section 4958 for excess benefits provided by a church would not be an inquiry or examination into the tax status or liability of the church itself and, thus, not a "church tax inquiry" as defined in section 7611(h)(2).

Issues for Consideration

Should 7611 protections be removed for a disqualified person's 4958 tax liability arising from excess benefits provided by a church?[119]

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[117] Staff of the J. Comm. on Taxation, 98th Cong., General Explanation of the Revenue Provisions of the Deficit Reduction Act of 1984 1140 (J. Comm. Print 1985).
[118] *Id.* at 1146-47.
[119] See IRS correspondence to Senator Grassley dated February 21, 2008, for information about IRS audit information regarding churches and 4958.

Appendix D: Other Tax-Exempt Organization Issues for Consideration

The issues and discussion impact all 501(c)(3) organizations, including churches and religious organizations. These issues are discussed in this memo because they are also issues for the churches we reviewed.

1) Governance & Self Dealing

Present law

Under section 508(e)(1), a private foundation is not exempt from taxation under section 501(a) unless its governing instrument prohibits the foundation from, among other things, engaging in any act of self-dealing as defined in section 4941(d).

Discussion

Section 4941 (imposing an excise tax on acts of self-dealing between a disqualified person and a private foundation) and Section 508 were enacted as part of The Tax Reform Act of 1969. The Senate Finance Committee report that accompanied the bill explains the section 508 provision as follows:

> To limit opportunities for improper self-dealing, and to facilitate appropriate action by State officials to supervise private foundations, the bill requires, as a condition of tax exemption, that the foundation's governing instrument prohibit it from engaging in self-dealing.
>
> ******
>
> In order to encourage and facilitate effective State involvement, the bill contains, as an additional condition of exemption for private foundations, a requirement that the governing instrument … prohibit self-dealing….[120]

But when section 4958 (imposing an excise tax on excess benefit transactions between a disqualified person and a section 501(c)(3) organization other than a private foundation) was enacted in 1996, it was not buttressed by a similar requirement that the governing instruments of non-private foundations prohibit excess benefit transactions. Imposing such a requirement as a condition of exemption for section 501(c)(3) organizations (other than private foundations) would work to "limit opportunities for" excess benefit transactions and "encourage and facilitate effective State involvement" in the supervision of such organizations.

Issue for Consideration

Should 508(e)(1) be amended to limit then exemption under section 501(c)(3) (other than a private foundation) to those with governing instruments that prohibit the organization excess benefit transactions (as currently defined in section 4958(c)(1))?

[120] S. Rep. No. 91-552, at 34, 56 (1969).

2) Excess Benefit Transactions

Charitable organizations are frequently criticized for the compensation packages they provide to their officers, directors, trustees and key employees, especially when the package includes luxury vehicles and private jets. Related party transactions and non-arms length transactions are another frequent complaint. The six media-based ministries were also subject to these criticisms and our reviews of each confirm that such criticisms are warranted. See the individual church overviews for more information.

However, the section 4958 excess benefits transactions excise tax is the only tool available to the IRS to combat unreasonable compensation, including salaries and perks. The provision was enacted in 1996 but final regulations were not issued until 2002. Over the past eight years, the provision, combined with the regulations, are generally considered ineffective. As a result, we are recommending the following changes to strengthen the provision.

a) Reason to Know Standard

Present law

Section 4958(a)(2) imposes an excise tax on any organization manager who "knowingly" participates in an excess benefit transaction, unless such participation is not willful and is due to reasonable cause. An "excess benefit transaction" is any transaction in which an economic benefit is provided by an applicable tax-exempt organization directly or indirectly to, or for the use of, any disqualified person if the value of the economic benefit provided exceeds the value of the consideration (including the performance of services) received for providing the benefit. An "organization manager" is any officer, director, or trustee of an organization, as well as any individual having powers or responsibilities similar to those of an officer, director, or trustee. Under Treasury regulations, an organization manager participates "knowingly" in a transaction only if he or she:

a) Has actual knowledge of sufficient facts so that, based solely on those facts, such transaction would be an excess benefit transaction;
b) Is aware that such a transaction, under the circumstances, may violate the tax law provisions governing excess benefit transactions; and
c) Negligently fails to make reasonable attempts to ascertain whether the transaction is an excess benefit transaction, or is in fact aware that it is such a transaction.[121]

The term "knowing" does not mean having reason to know; however, evidence tending to show that a manager has reason to know of a particular fact or particular rule is

[121] Treas. Reg. § 53.4958-1(d)(4)(i).

relevant in determining whether he or she had actual knowledge of such a fact or rule.[122]

An organization manager's participation in an excess benefit transaction will not ordinarily be considered "knowing" if the manager relies on a reasoned written opinion of an appropriate professional with respect to matters within the expertise of the professional.[123] The absence of a written opinion does not, by itself, create any negative inference that the organization manager's participation was "knowing." Appropriate professionals on whose written opinion an organization manager may rely are (1) legal counsel, including in-house counsel, (2) certified public accountants or accounting firms with expertise in the relevant tax law matters, and (3) independent valuation experts who hold themselves out to the public as appraisers or compensation consultants, perform the relevant valuations on a regular basis, are qualified to make valuations of the type of property or services involved, and include in the written opinion a certification that the three preceding requirements are met.[124] Similarly, a private foundation manager's participation in a self-dealing transaction will ordinarily not be considered knowing if he or she relies on the advice of legal counsel (including house counsel), though not of other persons.[125]

Furthermore, an organization manager's participation will not be considered knowing if the appropriate authorized body that approved the transaction meets the requirements for invoking the rebuttable presumption of reasonableness under Treas. Reg. § 53.4958-6(a) with respect to the transaction.[126]

Participation by an organization manager is "willful" if it is voluntary, conscious, and intentional, but not if the manager does not know that the transaction is an excess benefit transaction.[127]

Discussion

The current "knowing" standard is a high threshold, and provides extensive escape routes for those charged with setting and reviewing salaries.[128] By penalizing only knowing participants, the current rules create an incentive for managers to remain ignorant.[129] If excused from penalty when unaware that behavior violates a particular statute, managers have little reason to educate themselves about the law or the facts. But if they were made subject to tax when they should have known that particular behavior violated a statute, managers would likely take greater pains to learn about and

[122] Treas. Reg. § 53.4958-1(d)(4)(ii).
[123] Treas. Reg. § 53.4958-1(d)(4)(iii).
[124] Treas. Reg. § 53.4958-1(d)(4)(iii).
[125] Treas. Reg. § 53.4941(a)-1(b)(6).
[126] Treas. Reg. § 53.4958-1(d)(4)(iv).
[127] Treas. Reg. § 53.4958-1(d)(5).
[128] Jill S. Manny, Nonprofit Payments to Insiders and Outsiders: Is the Sky the Limit? 76 Fordham L. Rev. 735, 756 (2007).
[129] Bonnie Brier, A Critique of the Intermediate Sanctions Proposal Contained in the Revenue Reconciliation Act of 1995, H.R. 2491, 13 Exempt Org. Tax Rev. 211, 213 (1996).

deter wrongful acts.[130]

A "reason to know" standard is used in section 4965, which was enacted as part of the Tax Increase Prevention and Reconciliation Act of 2005. Section 4965 imposes an excise tax on an entity manager who approves or otherwise causes a tax-exempt entity to be a party to a prohibited tax shelter transaction, and knows, or has reason to know, that the transaction is a prohibited tax-shelter transaction. The conference report accompanying the bill includes an explanation of "reason to know":

> In general, the conferees intend that in order for an entity or entity manager to have reason to know that a transaction is a prohibited tax shelter transaction, the entity or entity manager must have knowledge of sufficient facts that would lead a reasonable person to conclude that the transaction is a prohibited tax shelter transaction. If there is justifiable reliance on a reasoned written opinion of legal counsel (including in-house counsel) or of an independent accountant with expertise in tax matters, after making full disclosure of relevant facts about such a transaction to such counsel or accountant, that a transaction is not a prohibited tax shelter transaction, then absent knowledge of facts not considered in the reasoned written opinion that would lead a reasonable person to conclude that the transaction is a prohibited tax shelter transaction, the reason to know standard is not met.
>
> Not obtaining a reasoned written opinion of legal counsel does not alone indicate whether a person has reason to know. However, if a transaction is extraordinary for the entity … or the transaction is of significant size, either in an absolute sense or relative to the receipts of the entity, then, in general, the presence of such factors may indicate that the entity or entity manager has a responsibility to inquire further about whether a transaction is a prohibited tax shelter transaction, or absent such inquiry, that the reason to know standard is satisfied.

The Treasury Department has issued proposed regulations under section 4965 that further explicate the "reason to know" standard.[131]

As a result, we recommend adoption of a "reason to know" standard. The Panel on the Nonprofit Sector recommended a adoption of such a standard in its 2005 report.[132]

b) Extend Excise Tax to Entity

Present law

[130] Nina J. Crimm, A Case Study of a Private Foundation's Governance and Self-Interested Fiduciaries Calls for Further Regulation, 50 Emory L.J. 1093, 1183 (2001).
[131] Excise Taxes on Prohibited Tax Shelter Transactions and Related Disclosure Requirements, 72 Fed. Reg. 36927 (proposed July 6, 2007) (to be codified at 26 C.F.R. pt. 53)
[132] Panel on the Nonprofit Sector in its 2005 report to Congress, Strengthening Transparency, Governance, and Accountability of Charitable Organizations 61 (2005).

Section 4958 imposes a tax on any disqualified person who engages in an excess benefit transaction with an applicable tax-exempt organization and on any organization manager who knowingly approves such transaction. But there is no tax imposed on the applicable tax-exempt organization that provides the excess benefit to the disqualified person.

Discussion

The lack of an entity-level tax under section 4958 stands in contrast to the treatment of private foundations involved in self-dealing transactions. For even though section 4941 imposes taxes for self-dealing only on the self-dealer and, in certain cases, the foundation manager, in most cases an act of self-dealing is also a "taxable expenditure" that subjects the foundation itself to tax under section 4945, because it is an amount paid for a noncharitable purpose.

When 4958 was enacted, Congress intentionally excluded the entity from being subject to the tax. Generally, it was thought that an organization was already harmed by an individual who received an excess benefit and, as a result, shouldn't be punished further.

Because no tax is imposed on the organization itself (or on any manager who does not "knowingly" participate), there is little incentive for the organization's governing body or managers to scrutinize transactions for excess benefits or to prevent excess benefit transactions from occurring.[133] When an organization's governing body lacks independence, as is the case with the six churches we reviewed, there is even less incentive.

As a result, we recommend extending section 4958 sanctions to organizations that provide an excess benefit if the authorizing body did not meet the minimum standard of due diligence recommended below.

c) Replace "Rebuttable Presumption" with "Minimum Standards for Due Diligence"[134]

Present rules

The House Ways and Means Committee report accompanying the 1996 Taxpayer Bill of Rights 2 – the legislation that added section 4958 to the Code – states that:

> "Excise benefit transactions" subject to excise taxes include transactions in which a disqualified person engages in a non-fair-market-value transaction with an

[133] Bonnie Brier, A Critique of the Intermediate Sanctions Proposal Contained in the Revenue Reconciliation Act of 1995, 13 Exempt Org. Tax Rev. 211, 213-14 (1996).
[134] A similar proposal was made by the staff of the J. Comm. on Taxation in 2005. *See* Staff of the J. Comm. on Taxation, 109th Cong., Options to Improve Tax Compliance and Reform Tax Expenditures 260 (2005).

> organization or receives unreasonable compensation…. Existing tax law standards (see sec. 162) apply in determining reasonableness of compensation and fair market value. In applying such standards, the Committee intends that the parties to a transaction are entitled to rely on a rebuttable presumption of reasonableness with respect to a compensation arrangement with a disqualified person … and with respect to the reasonableness of the valuation of property sold or otherwise transferred … by an organization to (or from) a disqualified person…. The Secretary of the Treasury and IRS are instructed to issue guidance in connection with the reasonableness standard that incorporates this presumption.[135]

In response, the Secretary issued rules that set out a procedure by which an organization can create a rebuttable presumption of reasonableness with respect to compensation arrangements and property transfers involving disqualified persons. Payments made by an applicable tax-exempt organization to a disqualified person under a compensation arrangement are presumed to be reasonable, and a transfer of property (or the right to use property) is presumed to be at fair market value, if:

1) The compensation arrangement or the terms of the property transfer are approved in advance by an authorized body of the organization composed entirely of individuals who do not have a conflict of interest with respect to the arrangement or transfer;
2) The authorized body obtained and relied on appropriate data as to comparability prior to making its determination; and
3) The basis for the determination is adequately and concurrently documented.[136]

The comparability data must be sufficient, given the knowledge and expertise of the members, for the authorized body to determine that the compensation arrangement in its entirety is reasonable or that the transaction is at the fair market value. In the case of compensation, such data may include (1) information regarding compensation levels paid by similarly situated organizations, both taxable and tax-exempt, for functionally comparable positions; (2) the availability of similar services in the geographic area of the organization; (3) compensation surveys compiled by independent firms; and (4) written offers from similar organizations competing for the services of a particular individual. In the case of property transactions, such data may include independent appraisals, as well as offers received as part of an open and competitive bidding process.[137]

If each of the requirements is met, the transaction is "presumed" to be reasonable or at fair market value. To rebut the presumption (and be able to impose the excise tax), the

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[135] H.R. Rep. No. 104-506, at 56-57 (1996); the rebuttable presumption of reasonableness found in the regulations to section 4958 does not have a statutory basis. The history of the presumption is recounted in: Staff of the J. Comm. on Taxation, 109th Cong., Options to Improve Tax Compliance and Reform Tax Expenditures 262, n.561 (2005).
[136] Treas. Reg. § 53.4958-6(a).
[137] Treas. Reg. § 53.4958-6(c)(2).

IRS must develop sufficient contrary evidence to rebut the probative value of the comparability data relied on by the authorized body. In the case of a fixed payment of compensation, the rebuttal evidence is limited to evidence relating to facts and circumstances existing on the date the parties entered into the contract.[138] The failure to qualify for the rebuttable presumption of reasonableness does not create any negative inference or implication that a transaction is an excess benefit transaction.[139]

Discussion

The rebuttable presumption of reasonableness is intended to be an incentive for organizations to adopt procedures that presumably protect against excess benefit transactions. It is based on the idea that "reasonableness" can be met through a good faith effort to find information on what similar organizations, both for-profit and nonprofit, pay their executives. But because many for-profit salary packages include stock options and incentives keyed to profits, the "gravitation to the mean" that typically occurs from the use of comparability data is likely to result in higher salaries at non-profit charities.[140]

Under the current section 4958 regime, once the procedures for establishing a rebuttable presumption are complied with, the burden of proof shifts to the IRS to develop sufficient contrary evidence to rebut the probative value of the comparability data used by the authorizing body. Shifting the burden of proof undermines the effectiveness of section 4958 by emphasizing process over substance. The effect of the presumption is to shift the focus from whether too much compensation was paid to whether appropriate procedures were followed. If the appropriate procedures were followed, an IRS agent examining the transaction would be inclined to abandon the issue, because the burden of developing sufficient contrary evidence would normally be too high.[141]

On the other hand, aside from the inflationary effect caused by reliance on "appropriate data as to comparability," the procedures used to satisfy the rebuttable presumption of reasonableness are commendable and ought to be encouraged. As a result, we recommend eliminating the rebuttable presumption but retaining the minimum standard of due diligence that have now become ubiquitous. This would shift the burden of proof back to organization managers and disqualified persons while incorporating existing best practices. However, we realize that removing the rebuttable presumption also removes the incentive to adopt those procedures. Thus, this recommendation would need to be considered in conjunction with the adoption of a "reason to know standard" (discussed above) as well as the proposal immediately following regarding establishing guidelines for, and requiring disclosure of, compensation studies.

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[138] Treas. Reg. § 53.4958-6(b).
[139] Treas. Reg. § 53.4958-6(e).
[140] Peter Frumkin & Alice Andre-Clark, Nonprofit Compensation and the Market, 21 U. Haw. L. Rev. 425, 464-465, 472 (1999).
[141] Staff of the J. Comm. on Taxation, 109th Cong., Options to Improve Tax Compliance and Reform Tax Expenditures 262-63 (2005).

d) Develop Guidelines & Require Disclosure of Compensation Studies

<u>Present law</u>

As noted above, the regulations for section 4958 permit organizations to rely on comparability data, including data from for-profit organizations, to establish the rebuttable presumption. Congress signaled that the use of for-profit compensation information was acceptable in the legislative history for section 4958.

<u>Discussion</u>

Since the regulations for section 4958 went into effect, the rebuttable presumption safe harbor, particularly the use of comparability data, has resulted in a "race to the top" in officer and key employee compensation. Throughout the course of charity investigations during the past nine years, including hospitals and religious organizations, Committee staff has obtained and reviewed many compensation studies. Often times, staff found that decision makers rely on a compensation consultant's analysis and simply rubber stamp the consultant's recommendation without challenging the consultant's assumptions.

A compensation report prepared for one of the six churches we reviewed refers to the biennial Southern Baptist Convention Compensation Study issued by the state Baptist conventions, GuideStone Financial Resources, and LifeWay Christian Resources. The 2008 Study reports that the average compensation of full-time senior pastors of Southern Baptist churches is $55,276, with an average "pay package" of $66,484. For purposes of the study, the term "compensation," as applied to ordained ministers, included salary, housing allowance, the fair rental value of church-owned housing, and utilities for church owned housing. The term pay package included "compensation" plus social security equivalent, retirement benefits, and insurance paid by the church. Full-time senior pastors of churches with budgets greater than $1 million received compensation between $52,033 and $303,902, with an average of $101,824, and pay packages between $65,999 and $364,000, with an average of $124,736. Full-time senior pastors of churches with an average of 1,000 or more attendees received compensation between $63,000 and $303,902, with an average of $127,744, and pay packages between $83,500 and $364,000 with an average of $155,689.[142]

Staff reviewed a compensation study prepared for one of the six churches by a leading compensation consulting firm that also does studies for for-profit organizations. The consulting company used data from the 2004 Southern Baptist Convention Compensation Study to justify high salaries for the minister. The Baptist Study reported the $236,000 as "high" compensation for a full-time pastor of a church with 1,000 or more members and an annual budget of $800,000. Thus, the consulting company argued that, since a minister reached between 5 million and 15 million people, and

[142] http://compstudy.lifeway.com/compstudy/homepage.do (last visited July 27, 2009)

since the church's annual budget is over $100 million, the minister should be compensated ten times $236,000. Taking into consideration the compensation of for-profit CEOs and media personalities like Oprah Winfrey, Britney Spears, Madonna, Rosie O'Donnell, and David Letterman, and mindful that the minister also receives income from book royalties and consulting fees, the consulting company recommended that the minister's total compensation be set at $2 million. Note, however, that minister is only able to "reach" millions of people through the media, i.e., they are not physically present in the church. Thus, we questioned whether television and radio audiences should have been compared to the number of attendees as the Baptist study did.

Ministers at another one of the six churches we reviewed have employment agreements that specify that their salaries shall be "comparable to the compensation of other pastors, secular CEOs, performers, and personalities whose ministries … businesses … or professional activities and production are of similar scope."

In compensation studies prepared for organizations other than churches, staff has noted that compensation consultants often make comparisons to organizations that are difficult to justify as being comparable when considering, among other things, revenues, number of employees, geographic location and activities. Yet, directors, trustees and others responsible for approving compensation packages rarely question the analysis conducted by the compensation consultants.

As a result we recommend developing guidelines for compensation studies, including when a comparison to for-profit organization is appropriate, and requiring public disclosure of the studies and data used to determine compensation. Again, this recommendation would need to be considered in conjunction with the adoption of a "reason to know standard" and the elimination of the rebuttable presumption as discussed above.

3) Income Exclusion for Gifts Received through Charitable Organizations

<u>Present Law</u>

Under section 102(a), gross income does not include the value of property acquired by gift, bequest, devise, or inheritance. Section 102(c) provides an exception for "employee gifts": there is no exclusion from gross income for any amount transferred by or for an employer to, or for the benefit of, an employee.

<u>Discussion</u>

Some of the ministers related of the churches we reviewed are reported to have received "love offerings." The 2006 audited financial statements of Without Walls International Church state that Randy and Paula White "receive gifts and love offerings that are passed through the church." And a church spokesperson for Eddie Long's New

Birth Missionary Baptist Church said that Long does not receive a salary from the church, but does take a "love offering."[143]

Larry L. McSwain, a professor at Mercer University's McAfee School of Theology, warns that "one of the practices of many churches, especially non-denominational and African-American ones, is to provide a love offering from the members to their pastor in place of salary. This technique is, for some, a way of avoiding the reporting of income."[144]

In 2007, Gregory L. Clarke, the pastor of a church, was convicted of tax fraud for underreporting and fraudulently misstating his taxable income on his 2000, 2001, and 2002 returns.[145] At trial, the defense argued that "Clarke received gifts, not salaries. Church deacons and trustees … testified the $60,000 given to Clarke was a 'love offering.'"[146] One news story reported that pastors of several local churches "testified that their churches gave Clarke money for preaching at revivals or fulfilling speaking engagements. However they said the money represented gifts, not pay." One pastor "testified his church gave Clarke two checks for $1,500 as a gift for preaching his annual appreciation day." Another pastor "identified for jurors a $125 check his church paid Clarke for participating in an annual leadership conference. [The pastor] insisted that the money was a gift to help defray costs."[147]

There is considerable confusion and misinformation about whether a "love offering" or similar payments to a minister should be treated as taxable income or as an excludable gift. Some commentators think the answer depends on whether the payor is able to deduct the payment as a charitable contribution. For example the Kansas Nebraska Convention of Southern Baptists, which defines a love offering as "an offering that is given from the heart to someone that has ministered to that very heart, and is not given simply because it is a tax-deductible charitable contribution," advises that "if the 'love offering' is received and designated for an individual for any occasion and the donor is not given a tax-deductible charitable contribution receipt, then the gift to the minister (recipient) is not considered taxable income." But "if the donors are given a tax-deductible charitable contribution receipt, the gift must then be considered income to the recipient."[148]

Whether a transfer is a gift for federal income tax purposes is a question of fact.[149] Although no definition of gift appears in the Code or the regulations, the Supreme Court stated that one of the essential elements of a gift is the existence of "detached and

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[143] Becky Ogburn, Who's Who?, News & Observer (Raleigh, NC), Jan. 20, 2008, at E2.
[144] Larry L. McSwain, Megachurch Probe Challenges All Church Ministries, http://ethicsdaily.com/news.php?viewStory=12010.
[145] *See* United States v. Clarke, 562 F. 3d 1158, 1164 (11th Cir. 2009).
[146] Val Walton, Clarke Guilty on All Counts; Baptist Minister Was Tried For Filing False IRS Returns, Birmingham News (Alabama), July 21, 2007, at 1A.
[147] Val Walton, Church Leaders Testify Pastor Got Gifts, Not Pay, Birmingham News (Alabama), July 18, 2007, at 1B.
[148] http://www.kncsb.org/legal/Love_Offerings.pdf.
[149] Comm'r v. Duberstein, 363 U.S. 278, 288 (1960).

disinterested generosity."[150] The transferor's intention is a significant factor in determining whether a transfer is a gift. It is more likely that the intent to make a gift can be proven when the transferor has not received, and does not expect to receive, anything in exchange for the transfer. For example, the Tax Court has held that payments to a taxpayer by two shareholders of the corporation for which the taxpayer had rendered services were excluded from the taxpayer's gross income as gifts because the taxpayer had been fully compensated and the shareholders, expecting nothing more in return, were merely being generous.[151] The likelihood that a transfer will be considered a gift is greater if the transferor is not under an obligation to make the transfer. But the absence of a legal obligation to make a transfer does not make a transfer a gift if it is made to protect the transferor's public image or to retain the goodwill of the recipient.[152]

On several occasions courts have found that payments by a congregation to its minister are not in the nature of a gift made out of detached and disinterested generosity but, instead, have the character of compensation for services. In reaching their conclusion, the courts emphasized that the payments were made in the context of a professional or service relationship between a minister and a group being ministered to (a church community or congregation), and not in the context of a family relationship or a personal friendship between individuals which is the usual setting for acts of detached and disinterested generosity. For example, in Banks v. Comm'r, church members transferred cash to their minister on four "special" days during the year "because she was their minister, she had done an outstanding job in the past, she was there to help them with their problems when they needed her, and they wanted to keep her as their minister in the future." The minister also drew a salary from the church. Holding that the cash transfers were taxable payments for services and not nontaxable gifts, the court said that "the transfers arose out of petitioner's relationship with her congregation as its minister…. The evidence indicates that the primary reason for the transfers … was not detached and disinterested generosity, but rather, the church members' desire to reward petitioner for her services as a pastor and their desire that she remain in that capacity…. There was strong, objective evidence that the amounts transferred … were part of a highly structured program for transferring money to petitioner on a regular basis…. The regularity of the payments from member to member and year to year indicated that they were the result of a highly organized program to transfer cash from church members to petitioner. The existence of such a program suggests that the transfers did not emanate from a detached and disinterested generosity, but instead, were designed to compensate petitioner for her service as a minister."[153]

In Goodwin v. United States, the court held that substantial payments given to a pastor and his wife on "special occasions" were taxable income, not excludable gifts. According to the court, "the critical fact … is that the special occasion gifts were made by the congregation as a whole, rather than by individual Church members. The cash

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[150] *Id.* at 285.
[151] Runyan v. Comm'r, T.C. Memo 1984-623.
[152] Biglow v. Comm'r, T.C. Memo 1985-284.
[153] Banks v. Comm'r, T.C. Memo 1991-641; Tax Ct. Memo LEXIS 700, 12-13.

payments were gathered by congregation leaders in a routinized, highly structured program. Individual Church members contributed anonymously, and the regularly-scheduled payments were made to the Rev. Goodwin on behalf of the entire congregation…. The special occasion gifts were substantial compared to Goodwin's annual salary.   The congregation, collectively, knew that, without these substantial, on-going cash payments, the Church likely could not retain the services of a popular and successful minister at the relatively low salary it was paying."[154]

And in Swaringer v. Comm'r, T.C. Summ. Op. 2001-37, the Tax Court held that transfers to a pastor out of "offerings" of the congregation were taxable income, not gifts. The pastor was not paid a regular salary by the church, but earned a living though employment as a secretary. The court said that the evidence strongly suggested that the transfers were not gifts because they "arose out of the [pastor's] relationship with the members of the congregation presumably because they believed he was a good minister and wanted to reward him."

Since one's impulse to contribute, as a member of a congregation, to a love offering or other solicitation of money for the benefit of a minister will always be motivated, in part, by feelings of appreciation, gratitude, or indebtedness for the minister's ministry to that congregation (i.e., provision of services) and not simply by feelings of "detached or disinterested generosity" between individuals, amounts collected by or through the agency of church for the benefit of their minister should not be considered gifts excludable from gross income under section 102. Although section 102(c) denies gift treatment to amounts transferred by an employer to an employee, it is not always the case that the minister is an employee of the congregation from which the love offering or other payment is transferred. A minister is considered a self-employed individual for social security act purposes and may also be considered self-employed for income tax or retirement plan purposes unless employed by a congregation for a salary.[155]

Issue for Consideration

Should "love offerings" or other similar donations be excluded from the gross income of the recipient when a charitable organization has facilitated those collections?

Should the analysis be different if the recipient is a "disqualified person"?

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[154] Goodwin v. United States, 67 F.3d 149, 152 (8th Cir. 1995).
[155] Internal Revenue Service, Publication 517, Social Security and Other Information for Members of the Clergy and Religious Workers 3 (2008).

Appendix E: Eliminate or Circumscribe Electioneering Prohibition

Present law

(1) Tax Law

(a) Electioneering Prohibition

An organization cannot be exempt from federal income tax as an organization described in section 501(c)(3) unless it "does not participate in, or intervene in (including the publishing or distributing of statements), any political campaign on behalf of (or in opposition to), any candidate for public office." The regulations provide that activities that constitute participation or intervention in a political campaign include, but are not limited to, the publication or distribution of written or printed statements or the making of oral statements on behalf of, or in opposition to, a candidate for public office.[156] A determination whether an organization has participated or intervened is based upon all the relevant facts and circumstances. This prohibition on political campaign intervention by section 501(c)(3) organizations is referred to as the "electioneering prohibition" for short.

Under section 4955, an amount paid or incurred by a section 501(c)(3) organization to participate in, or intervene in, a political campaign for public office is considered a "political expenditure."[157] Section 4955(a) imposes an initial tax on each political expenditure by a section 501(c)(3) organization equal to 10 percent of the amount of the expenditure. In addition, an initial tax equal to 2½ percent of the organization's political expenditures is imposed on any organization manager who agrees to the making of any expenditure, knowing it to be a political expenditure. If the expenditure is not promptly corrected, section 4955(b) imposes an additional tax equal to 100 percent of the political expenditure upon the organization, and an additional tax equal to 50% of the expenditure upon any manager who refuses to agree to the correction.

Section 6852 authorizes the IRS to immediately determine the amount of income tax and section 4955 tax due from an organization that flagrantly violates the electioneering prohibition, which taxes shall be immediately due and payable.

Section 7409 authorizes the IRS to seek an injunction from a federal district court prohibiting any further political expenditures by an organization that "has flagrantly participated in, or intervened in . . . any political campaign" and that has not ceased the expenditures upon being notified that the Service intends to seek an injunction.

(b) Lobbying Restriction

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[156] Treas. Reg. 1.501(c)(3)-1(c)(3) (iii).
[157] I.R.C. § 4955(d)(1).

An organization is exempt under section 501(c)(3) only if "no substantial part of [its] activities is carrying on propaganda, or otherwise attempting, to influence legislation (except as otherwise provided in [section 501](h))."

Thus, section 501(c)(3) allows organizations exempt under that section to lobby so long as they do not devote a substantial part of their activities to attempting to influence legislation. The IRS has not adopted a percentage test for determining whether a substantial part of an organization's activities consist of lobbying; rather, a facts and circumstances test is used. But in one court case, the court held that an organization's attempts to influence legislation that constituted less than five percent of the organization's total activities were not substantial.[158] In another case, the court noted that an organization's expenditures for lobbying activities ranged from 16.6 to 20.5 percent of total expenditures during a four-year period, and concluded that "for an organization "to devote so much of its total resources to legislative activities, it fairly can be concluded that its purposes no longer accord with conceptions traditionally associated with common-law charity."[159]

Section 501(h) of the Code, enacted in 1976, allows section 501(c)(3) public charities to elect to have their lobbying activities governed by expenditure tests in lieu of being subject to the "substantial part" test (churches and private foundations and not allowed to make the election). A public charity that makes the election may make lobbying expenditures within specified dollar limits determined under section 4911. If an electing public charity's lobbying expenditures are within the dollar limits determined under section 4911(c), the electing public charity will not owe tax under section 4911, nor will it lose its tax-exempt status. If, however, the electing public charity's lobbying expenditures exceed its section 4911 lobbying limit, the organization is subject to an excise tax on the excess lobbying expenditures. Further, if an electing public charity's lobbying expenditures normally are more than 150 percent of its section 4911 lobbying limit, the organization's tax-exempt status as a section 501(c)(3) organization will be revoked.

A public charity that elects the expenditure test may nevertheless lose its tax exempt status if it is an action organization, i.e., its main or primary objective or objectives (as distinguished from its incidental or secondary objectives) may be attained only by legislation or a defeat of proposed legislation; and it advocates, or campaigns for, the attainment of such main or primary objective or objectives as distinguished from engaging in nonpartisan analysis, study, or research and making the results thereof available to the public.[160]

In <u>Regan v. Taxation With Representation of Washington</u>, 461 U.S. 540 (1983), the Supreme Court ruled that the section 501(c)(3) lobbying restriction is constitutional. TWR, a section 501(c)(3) organization, argued that the lobbying limitation violated its right to freedom of speech under the First Amendment.

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[158] <u>Seasongood v. Comm'r</u>, 227 F.2d 907, 912 (6th Cir. 1955).
[159] <u>Haswell v. United States</u>, 205 Ct. Cl. 421, 443-44 (1974).
[160] Treas. Reg. 1.501(c)(3)-1(c)(3).

In holding that the lobbying restriction does not violate the First Amendment, the Court posited that—

> Both tax exemptions and tax-deductibility are a form of subsidy that is administered through the tax system. A tax exemption has much the same effect as a cash grant to the organization of the amount of tax it would have to pay on its income. Deductible contributions are similar to cash grants of the amount of a portion of the individual's contributions. The system Congress has enacted provides this kind of subsidy to … those charitable organizations that do not engage in substantial lobbying. In short, Congress chose not to subsidize lobbying as extensively as it chose to subsidize other activities that non-profit organizations undertake to promote the public welfare…. [161]

Relying on Cammarano v. United States, 358 U.S. 498 (1959) – in which the Court upheld a Treasury regulation that denied business expense deductions for lobbying activities, holding that Congress is not required by the First Amendment to subsidize lobbying – the Court in TWR said—

> The Code does not deny TWR the right to receive deductible contributions to support its non-lobbying activity, nor does it deny TRW any independent benefit on account of its intention to lobby. Congress has merely refused to pay for lobbying out of public monies…. Congress has not infringed any first Amendment rights or regulated any First Amendment activity. Congress has simply chosen not to pay for TWR's lobbying.[162]

(2) Campaign Finance Law

In Buckley v. Valeo, 424 U.S. 1 (1976), the Supreme Court considered the constitutionality of the Federal Election Campaign Act of 1971 (FECA), as amended in 1974. The Court upheld the constitutionality of certain statutory provisions, including contribution limitations to candidates for federal office and disclosure and record-keeping provisions. But the Court found other provisions unconstitutional, including a $1,000 limitation on independent expenditures. Former 18 U.S.C. § 608(e)(1), which the appellants contended is unconstitutionally vague, provides that "no person may make any expenditure … relative to a clearly identified candidate during a calendar year which, when added to all other expenditures made by such person during the year advocating the election or defeat of such candidate, exceeds $1,000." Noting that "vague laws may not only 'trap the innocent by not providing fair warning' or foster arbitrary and discriminatory application' but also operate to inhibit protected expression by inducing 'citizens to steer far wider from the unlawful zone … than if the boundaries of the forbidden areas were clearly marked,'"[163] the Court observed that "although 'expenditure,' 'clearly identified,' and 'candidate' are defined in the Act, there is no definition clarifying what expenditures are 'relative to' a candidate. The use of so

[161] Regan v. Taxation With Representation of Washington, 461 U.S. 540, 544 (1983).
[162] *Id.* at 545-46.
[163] Buckley v. Valeo, 424 U.S. 1, 41 n.48 (1976).

indefinite a phrase as 'relative to' a candidate fails to clearly mark the boundary between permissible and impermissible speech …."[164] The Court said that, although the context of section 608(e)(1) "clearly permits, if indeed it does not require, the phrase 'relative to' a candidate to be read to mean 'advocating the election or defeat of' a candidate [it is a mistake to think] that this construction eliminates the problem of unconstitutional vagueness altogether."[165]

> [T]he distinction between discussion of issues and candidates and advocacy of election or defeat of candidates may often dissolve in practical application. Candidates, especially incumbents, are intimately tied to public issues involving legislative proposals and governmental actions. Not only do candidates campaign on the basis of their positions on various public issues, but campaigns themselves generate issues of public interest. In an analogous context, this Court in <u>Thomas v. Collins</u>, 323 U.S. 516 … (1945), observed:
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> > [W]hether words intended and designed to fall short of invitation would miss the mark is a question both of intent and of effect. No speaker, in such circumstances, safely could assume that anything he might say upon the general subject would not be understood by some as an invitation. In short, the supposedly clear-cut distinction between discussion, laudation, general advocacy, and solicitation puts the speaker in these circumstance wholly at the mercy of the varied understanding of his hearers and consequently of whatever inference may be drawn as to his intent and meaning. Such a distinction offers no security for free discussion. In these conditions it blankets with uncertainty whatever may be said. It compels the speaker to hedge and trim.[166]

The Court then concluded that:

> The constitutional deficiencies described in "Thomas v. Collins" can be avoided only by reading s 608(e)(1) as limited to communications that include explicit words of advocacy of election or defeat of a candidate, much as the definition of "clearly identified" in s 608(e)(2) requires that an explicit an unambiguous reference to the candidate appear as part of the communication…. We agree that in order to preserve the provision against invalidation on vagueness grounds, s 608(e)(1) must be construed to apply only to expenditures for communications that in express terms advocate the election or defeat of a clearly identified candidate for federal office.[167]

The Court said that "[t]his construction would restrict the application of § 608(e)(1) to communications containing express words of advocacy of election or defeat, such as

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[164] *Id*. at 41.
[165] *Id.* at 42.
[166] *Id.* at 42-43.
[167] *Id.* at 43-44.

‘vote for,’ ‘elect,’ ‘support,’ ‘cast your ballot for,’ ‘Smith for Congress,’ ‘vote against,’ ‘ defeat,’ ‘reject.’”[168]

The Bipartisan Campaign Reform Act of 2002 (BCRA), P.L. 107-155 (H.R. 2356, 107th Cong.) significantly amended the FECA. Section 203 of the BCRA prohibits corporations and labor unions from using their general treasury funds (and any person from using funds donated by a corporation or labor union) to finance electioneering communications. Instead, the statute requires that such ads be paid for with corporate or labor union political action committee (PAC) regulated hard money.

Section 201 of the BCRA defines “electioneering communication” as any broadcast, cable, or satellite communication that refers to a clearly identified candidate for Federal office, is made within 60 days of a general election or 30 days of a primary election or political party caucus, and, in the case of a communication that refers to a candidate for an office other than President or Vice President, is targeted to the relevant electorate.[169] But if such definition is “held to be constitutionally insufficient by final judicial decision,” Section 201 provides, alternatively, that the term “electioneering communication” means “any broadcast, cable, or satellite communication which promotes or supports a candidate for [Federal] office, or attacks or opposes ad candidate for that office (regardless of whether the communication expressly advocates a vote for or against a candidate) and which also is suggestive of no plausible meaning other than an exhortation to vote for or against a specific candidate.”

In McConnell v. FEC, 540 U.S. 93 (2003), the Supreme Court held that neither the First Amendment nor Buckley prohibits BCRA’s regulation of “electioneering communications,” even though such communications do not contain express advocacy. The Court found that the speech regulated by section 203 of the BCRA was the “functional equivalent” of express advocacy. The Court said that the distinction made by Buckley between express and issue advocacy was a matter of statutory interpretation, not constitutional command, and that Buckley’s narrow reading of the FECA provisions to avoid problems of vagueness and overbreadth “did not suggest that a statute that was neither vague nor overbroad would be required to toe the same express advocacy line.”[170] While section 203 prohibits corporations and labor unions from using their general treasury funds for electioneering communications, the Court observed that they are still free to use separate segregated funds (PACs) to run such ads. Therefore, the Court concluded that it is erroneous to view this provision of BCRA as a “complete ban” on expression rather than simply a regulation.[171]

In Fed. Election Comm’n v. Wisconsin Right to Life, Inc., 127 S. Ct. 2652 (2007), the Supreme Court held that section 203 of the BCRA was unconstitutional as applied to ads broadcast by WRTL. Those ads accused a group of Senators of filibustering to delay and block federal judicial nominees, and told voters to contact Wisconsin

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[168] *Id.* at 44 n.52.
[169] 2 U.S.C. 434(f)(3)(A)(i).
[170] McConnell, 540 U.S. at 192.
[171] *Id.* at 204.

Senators Feingold and Kohl to urge them to oppose the filibuster. Recognizing that the ads would be illegal "electioneering communications" under section 203 of the BCRA if run within 30 days of the Wisconsin primary, but believing it had a First Amendment right to broadcast them, WRTL filed suit against the FEC seeking declaratory and injunctive relief and alleging that section 203's prohibition was unconstitutional as applied to those ads. The Court said that because section 203 burdens political speech, it is subject to strict scrutiny under which the government must prove that applying BCRA to WRTL's ads furthers a compelling governmental interest and is narrowly tailored to achieve that interest. While recognizing that McConnell had ruled that the BCRA survives strict scrutiny to the extent it regulates express advocacy or its functional equivalent, the Court said that McConnell did not establish an intent-and-effect test for determining if a particular ad is the functional equivalent of express advocacy, and did not purport to overrule Buckley, which rejected an intent-an-effect test for distinguishing between discussions of issues and candidates. The Court found that, because the ads may reasonably be interpreted as something other than an appeal to vote for or against a specific candidate, they are not the functional equivalent of express advocacy and therefore fall outside McConnell's scope. To safeguard freedom of speech on public issues, a court should find that an ad is the functional equivalent of express advocacy only if the ad is susceptible to no reasonable interpretation other than as an appeal to vote for or against a specific candidate.[172] The Court held that because WRTL's ads were not express advocacy or its functional equivalent, and because the FEC identified no interest sufficiently compelling to justify burdening WRTL's speech, section 203 of the BCRA was unconstitutional as applied to the ads.

In Citizen's United v. Fed. Election Comm'n, 530 F. Supp. 2d 274 (D.D.C. 2008), the District Court rejected the plaintiff's claim that section 203 of the BCRA violated the First Amendment on its face. The Supreme Court, however, agreed that BCRA did in fact violate free speech rights.[173]

Past Legislative Proposals to Amend the Electioneering Prohibition

Legislation has been introduced in the past several Congresses that would have allowed churches to participate in at least some campaign activity without jeopardizing their tax-exempt status.[174]

In the 107th Congress, the Houses of Worship Political Speech Protection Act (H.R. 2357) would allow churches to engage in campaign activity so long as such activity was "no substantial part" of the church's activities. The "no substantial part" test is a flexible test, and would require the IRS to judge each church on a case-by-case basis.[175] And

[172] WRTL, 127 S. Ct. at 2667.
[173] Citizens United v. FEC, 130 S. Ct. 876 (U.S. 2010)
[174] Erika K. Lunder & L. Paige Whitaker, Churches and Campaign Activity: Analysis of the Houses of Worship Free Speech Restoration Act and Similar Legislation, Congressional Research Service, at 1 (2009)
[175] *Id*. at 6.

the Bright-Line Act of 2001 (H.R. 2931) would allow a church to engage in campaign activity as long as it did not normally make expenditures for campaign activity in excess of 5 percent of its gross revenues and as long as it did not normally spend more than 20 percent of its gross revenues on campaign and lobbying activities combined. The bill did not define "normally."

In the 108th Congress, a provision in the American Jobs Creation Act of 2004, H.R. 4520, as originally introduced, would add a new subsection to section 501, entitled "Safe Harbor for Churches," which would provide that:

- A church would not be treated as having engaged in electioneering because of a statement by one of its religious leaders which is clearly identified as a statement made as a private citizen and not made on behalf of the church.
- A church would not lose its tax-exempt status unless its leaders unintentionally engage in electioneering on more than three separate occasions during any calendar year or intentionally engage in electioneering.

H.R. 4520 would also add a new section to the Code imposing a tax on churches for "impermissible activities," i.e., electioneering. If a church unintentionally engages in electioneering on three occasions during a calendar year, it would be subject to a tax equal to the highest corporate tax rate multiplied by the organization's gross income for the calendar year. The amount would be reduced by 1/52 if there is only one violation in the year or by ½ if there are only two violations during the year. Any tax imposed under this new section would be reduced by the amount of any tax imposed under section 4955.[176]

The Houses of Worship Free Speech Restoration Act (H.R. 235) was introduced in both the 108th and 109th Congresses. It would add a new subsection to section 501 providing that a church would not lose its tax-exempt status or be deemed to have engaged in electioneering "because of the content, preparation, or presentation of any homily, sermon, teaching, dialectic, or other presentation made during religious services or gatherings."

In the 110th Congress, H.R. 2275 would repeal the political campaign prohibition entirely, in which case a church's political campaign activity would be limited only by the general section 501(c)(3) requirement that the church be organized and operated exclusively for exempt purposes. Churches and other section 501(c)(3) organizations would still be subject to the section 4955 tax on political expenditures.[177]

Discussion

The electioneering prohibition on section 501(c)(3) organizations should be repealed or circumscribed with respect to churches and other section 501(c)(3) organizations (other than private foundations) because "the game is not worth the candle." The IRS is required to draw on its limited resources to police a provision that has no express

[176] *Id.* at 5
[177] *Id.* at 4.

purpose that can be deduced from the legislative history,[178] is harsher than what is necessary to address legitimate policy concerns, is vague (and therefore difficult for charities to comply with and for the IRS to enforce), and rarely results in any punishment being imposed on non-complying organizations or excise tax revenues being collected for the U.S. Treasury. Several legal scholars have questioned the constitutionality of the prohibition.[179] The only sure effect of the prohibition has been to cause headaches for the IRS, especially when a church is accused of overstepping the prohibition's tenuous borders.[180]

A Prohibition Without a Purpose? Congress Gave No Reasons for Enacting the Electioneering Prohibition

Although "charitable" organizations have been exempt from paying federal income tax for as long as there has been a tax, it was not until 1934 that any limits were placed on their political activities, and then only on lobbying, not electioneering. An early Senate version of the bill that would become the Revenue Act of 1934 proposed limits on electioneering as well as a lobbying by denying a charitable contribution deduction for "contributions made to an organization a substantial part of whose activities is participation in partisan politics or in carrying on propaganda, or otherwise attempting to influence legislation."[181] However, the Conference Committee deleted the "partisan politics" language, one congressman stating that "we were afraid that this prohibition was too broad, and we succeeded in getting the Senate conferees to eliminate [the provision concerning] partisan politics."[182] Thus, the 1934 Revenue Act imposed a restriction on lobbying only.

But in 1954, then-Senator Lyndon B. Johnson introduced a floor amendment to the Revenue Act of 1954 that would prohibit electioneering by section 501(c)(3) organizations. No hearings were held on the subject, and there is no discussion of the Johnson amendment in the Act's legislative history, but Johnson's remarks on the

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[178] *See, e.g.,* Deirdre Dessingue, Prohibition In Search of a Rationale: What the Tax Code Prohibits; Why; To What End? 42 B.C. L. Rev. 903. (2001).
[179] *See, e.g.,* Laura Brown Chisolm, Politics and Charity: A Proposal For Peaceful Coexistence, 58 Geo. Wash. L. Rev. 308 (1990); Erik J. Ablin, The Price of Not Rendering to Caesar: Restrictions On Church Participation in Political Campaigns, 13 Notre Dame J.L. Ethics & Pub. Pol'y 541 (1999); Steffen N. Johnson, Of Politics and Pulpits: A First Amendment Analysis of IRS Restrictions on the Political Activities of Religious Organizations, 42 B.C. L Rev. 875 (2001); Chris Kemmitt, RFRA, Churches and the IRS: Reconsidering the Legal Boundaries of Church Activity in the Political Sphere, 43 Harv. J. on Legis. 145 (2006); Keith S. Blair, Praying for a Tax Break: Churches, Political Speech, and the Loss of Section 501(c)(3) Tax Exempt Status, 86 Denv. U.L. Rev. 405 (2009).
[180] For example, the Alliance Defense Fund (ADF) is intent on challenging the constitutionality of the electioneering prohibition. During the 2008 presidential campaign, ADF organized Pulpit Freedom Sunday, when "32 pastors in different parts of the country spoke out on candidates and their stands on the issues during church services, hoping to provide the IRS into revoking participating churches' exemptions and thereby spark a showdown in court. So far, the IRS response has been silence, so the ADF is planning another effort for this fall. An ADF attorney said Pulpit Freedom Sunday will take place every year until pastors have the right to preach freely from their pulpits." 2009 TNT 145-6 (July 31, 2009).
[181] S. Rep. no. 558, 73d Cong., at 26 (1934).
[182] 78 Cong. Rec. 7831 (1934).

Senate floor suggest that he intended merely to extend the existing lobbying restrictions to electioneering and not to creating a new, more punitive regime for electioneering.[183]

Revocation is Toughest Sanction

Section 501 of the Internal Revenue Code effectuates Congress's determination to favor organizations set up and operated to further certain purpose deemed beneficial to society at large (such as religious, charitable, and educational purposes) by exempting such organizations from federal income tax. Similarly, with section 170(c)(2), Congress encourages the public to support organizations that further religious, charitable, educational, and other "exempt" purposes, by allowing a deduction from federal income tax for contributions to such organizations. It is logical that Congress would not want tax-exempt organizations to engage in activities that further a purpose that is not one of those for which tax exemption is accorded. Likewise, it is logical that Congress would not want tax-deductible contributions used to further a purpose that is not one of the purposes that the charitable contribution deduction was meant to encourage. Under common law, political purposes are not considered to be charitable purposes. Reflecting case law, the Restatement of the Law on Trusts, Second, says that "a trust to promote the success of a particular political party is not charitable."[184] Therefore, it is logical that Congress would want to discourage tax-exempt organizations from engaging in political activities.

But other kinds of activities that do not further an exempt purpose are discouraged under the tax law without resort to revocation of exemption for the slightest infraction. The general rule is that a section 501(c)(3) organization must engage *primarily* in activities that accomplish exempt purposes; i.e., an organization is not regarded as operated exclusively for exempt purposes if more than an insubstantial part of its activities is not in furtherance of an exempt purpose.[185] Put another way, an organization generally will not lose its exemption under section 501(c)(3) for merely engaging in an activity that is not in furtherance of exempt purposes as long as non-exempt activities do not constitute a substantial part of overall activities. For example, an exempt organization may operate a trade or business and maintain its exemption as long as it is not organized and operated for the primary purpose of carrying on an unrelated trade or business.[186] Rather than revoke the exempt status of an organization that engages in an unrelated trade or business, the Code subjects the organization to a tax on its unrelated business income.[187]

The lobbying restrictions are in harmony with this "insubstantial part" rule, because they condone an insubstantial level of lobbying. An organization that elects to limit its

[183]The transcript in the Congressional Record reads: "Mr. Johnson of Texas: Mr. President, this amendment seeks to extend the provisions of section 501 of the House bill, denying tax-exempt status to not only those people who influence legislation but also to those who intervene in any political campaign on behalf of any candidate for any public office" (100 Cong. Rec. 9604 (1954))
[184] Restatement (Second) of Trusts § 374, cmt. k (1959).
[185] Treas. Reg. § 1.501(c)(3)-1(c)(1).
[186] Treas. Reg. § 1.501(c)(3)-1(e).
[187] I.R.C. §§ 511-514.

lobbying expenditures to the levels prescribed in section 501(h) and 4911 is subject to tax only if it exceeds those expenditure levels, and it does not risk the loss of exemption unless in substantially exceeds those levels over the course of several years. In contrast, the absolute ban on electioneering with its hair-trigger revocation penalty is an anomaly.

Although electioneering is not the only activity that is absolutely proscribed by the terms of section 501(c)(3), it is the only proscribed activity for which there is no effective alternative. For example, section 501(c)(3) also contains a prohibition on inurement; i.e., “no part of the net earnings” of a section 501(c)(3) organization may “[inure] to the benefit of any private shareholder or individual.” But because “inurement” is difficult to prove (much less understand), and the penalty, even for a scintilla of inurement is so onerous (revocation of tax-exempt status), the inurement prohibition is rarely enforced. Eventually Congress enacted section 4958 to impose taxes, as an alternative to revocation, with respect to certain types of inurement (known as excess benefit transactions) involving public charities. Treasury regulations to section 4958 set out procedures that charities can follow to establish the reasonableness of their transactions with insiders, thereby giving charities a degree of confidence that such transactions will not be considered inurement that results in revocation.

Like inurement, the precise scope of proscribed electioneering is difficult to define. Like the inurement prohibition, the electioneering prohibition imposes an onerous penalty on an offending organization – loss of tax-exempt status. But unlike inurement, there is no alternative, less onerous scheme, similar to section 4958, for deterring electioneering. For although section 4955 imposes taxes on political expenditures, most violations of the electioneering prohibition do not involve “expenditures,” but merely speech, and section 4955 provides no “safe harbor” by which a charity might establish that certain speech is permissible issue advocacy rather than impermissible electioneering.

The problem with an absolute prohibition on electioneering is that there is no “bright line” between issue advocacy and partisan politics. The IRS can construe speech to be electioneering even if no mention is made of an election or a person’s status as a candidate for public office. For example, the James Madison Center for Free Speech filed a lawsuit in federal district court challenging an IRS determination that Catholic Answers, a section 501(c)(3) charity, had made “political expenditures” because its president, Karl Keating posted a message on the organization’s website prior to the 2004 election in which he argued that John Kerry (then a presidential candidate) should not receive Holy Communion because of his “pro-abortion” positions. The lawsuit accuses the Treasury regulations of being vague and overbroad and, consequently, of chilling the First Amendment free speech rights of non-profit organizations. The suit asks that the regulations on “political intervention” be struck down or narrowly construed to encompass only speech that expressly advocates the election or defeat of a clearly identified candidate.[188]

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[188] Complaint available at http://www.jamesmadisoncenter.org/CAKK/CAKKComplaint.pdf

The Parameters of a “Facts-and-Circumstances” Electioneering Test are Difficult to Circumscribe

While the IRS has issued guidance to help charities understand the types of behavior that could constitute electioneering,[189] the “facts and circumstances” approach used by the IRS for determining a violation of the ban causes church and charity officials a great deal of confusion and anxiety. A Congressional Research Service report says that “the statute and regulations do not offer much insight as to what [electioneering] activities are prohibited.”[190]

Even the IRS officials responsible for investigating violations of the electioneering prohibition have difficulty discerning its scope. An audit by the Treasury Inspector General for Tax Administration (TIGTA) found that “[IRS] employees responsible for identifying and researching referrals with alleged political interventions … did not always understand why certain referrals were not included in the initiative [by the Referral Committee].” TIGTA recommended that the director of the IRS’s EO function “seek to improve the consistent understanding of prohibited political intervention criteria within the EO function.”[191]

Enforcement Efforts Sap IRS Resources And Revocations are Rare

Proving a violation of the electioneering prohibition, like proving inurement, is often difficult. And proving electioneering by church officials is particularly fraught with difficulty because the IRS is prohibited by the church audit procedures of section 7611 from conducting a church tax inquiry or examination unless a “high-level Treasury official reasonably believes (on the basis of facts and circumstances recorded in writing) that the church” has engaged in activity that puts its tax-exempt status in doubt. The staff of the Joint Committee on Taxation found that the church audit procedures “[make] it more difficult for the IRS to initiate an examination of a church even if there is clear evidence of impermissible activity on the part of the church and [hampers] IRS efforts to educate churches with respect to actions that are not permissible, such as what constitutes impermissible political campaign intervention.”[192]

Testifying before the House Ways and Means Committee in 2002, then-director of the IRS Exempt Organizations office, Steven Miller, said “this is a challenging area for the IRS to administer. This is not the first time that Congress has reviewed our activities in this area.” Miller went on to list some of those challenges:

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[189] *See, e.g.,* Rev. Rul. 2007-41, 2007-25 I.R.B. 1421.
[190] Erika Lunder, Tax-Exempt Organizations: Political Activity Restrictions and Disclosure Requirements, Cong. Res. Serv., Sept. 11, 2007.
[191] Treasury Inspector General For Tax Administration, Improvements Have Been Made to Educate Tax-Exempt Organizations and Enforce the Prohibition Against Political Activities, but Further Improvements Are Possible 2-3 (June 18, 2008).
[192] Staff of the Joint Committee on Taxation, Report of Investigation of Allegations Relating to Internal Revenue Service Handling of Tax-Exempt Organization Matters, JCS-3-00, at 19 (2000).

> First we have the issue of attribution. Was an individual making a pronouncement in his or her individual capacity, or can the pronouncement be attributed to the tax-exempt organization…?
>
> A second difficult issue is whether a given pronouncement constitutes political campaign intervention. In this area specifically, the IRS is faced with reviewing both the content and circumstances surrounding the distribution of voter guides during worship services or on church property….
>
> Finally, the section 4955 excise tax that can be used in lieu of revocation may not be effective [because] the tax is based on expenditures. Yet there are times when this excise tax does not correspond to the prohibited intervention. For example what is the expenditure related to an endorsement of a candidate during a sermon from the pulpit? … [All] these considerations … taken together … make the area more challenging to regulate.[193]

Before 2004, the IRS only occasionally looked into third-party allegations electioneering activities. Miller testified at the 2002 Hearings that the IRS had "revoked religious organizations or religious-affiliated organizations four or five times in the last 20 years."[194] But because the IRS "has seen a growth in the number and variety of allegations of [charities intervening in political campaigns] during election cycles … coupled with the dramatic increases in money spent during political campaigns," the IRS initiated a Political Activities Compliance Initiative (PACI) for the 2004 election cycle, the objective of which was to promote compliance with the electioneering ban by expeditiously reviewing allegations of political intervention by tax-exempt organizations and initiating examinations when deemed appropriate. Since the 2004 Initiative, the IRS has continued to conduct political activity compliance initiatives during Federal election years.

For the 2004 Initiative, the IRS received 166 referrals alleging prohibited political campaign intervention by section 501(c)(3) organizations, among which were nineteen allegations that a church official had endorsed a political candidate during regular church services. The number of referrals is quite small considering that GuideStar reports that there are 1.8 million "IRS-recognized tax-exempt organizations,[195] and the Yearbook of American and Canadian Churches reports that there are 331,000 church congregations in the United States.[196] The IRS selected 110 organizations for examination, including 47 churches. The examinations mainly concerned tax-exempt organizations that had allegedly been involved in a single instance of potentially prohibited electioneering. Forty-six referrals alleged the distribution of printed materials such as printed documents or signs supporting a particular candidate or biased voter

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[193] Review of Internal Revenue Code Section 501(c)(3) Requirements for Religious Organizations, Hearing Before the Subcomm. On Oversight of the H. Comm. On Ways and Means, 107th Cong. (2002).
[194] *Id.* at 15 (2002).
[195] http://www2.guidestar.org/rxg/analyze-nonprofit-data/index.aspx; GuideStar maintains a database of tax-exempt organizations.
[196] Julia Duin, Americans Leaving Churches in Droves, Washington Times, Sept. 21, 2008, at A09.

guides. Thirty-five referrals alleged improper verbal statements, such as a church official endorsing a candidate during church services, or candidates making campaign speeches at functions sponsored by a tax-exempt organization. Thirty-four referrals alleged the distribution of prohibited electioneering material electronically such as on a Website or in an email. And fifteen referrals alleged inappropriate political contributions. In the majority of cases, the examination concluded with the IRS issuing a closing letter to the tax-exempt organization warning the organization of the consequences of future prohibited electioneering. However, six examinations resulted in the revocation of the organization's tax-exempt status. Of the 107 examinations concluded by December 2008, the IRS had substantiated electioneering by sixty two organizations.[197]

The Treasury Inspector General for Tax Administration, in its audit of the 2004 Initiative, observed that excise taxes on political activities are difficult to assess either because "tax-exempt assets were not used" or because "it is difficult to calculate the amount of tax-exempt assets used in a prohibited activity…. As a result, it is rare for the IRS to assess excise taxes at the conclusion of an examination…. In 5 of the 99 cases, the IRS assessed excise taxes in the amount of $12,945.37." The audit report also observed that "by their very nature, IRS examinations are highly intrusive and require resources of both the IRS and the tax-exempt organization being examined. In addition, some political activity examinations are lengthy due to their complexity and the fact that certain cases involve additional legal requirements that must be followed," probably an allusion to the church audit procedures. "For example, some of the initial examinations in the 2004 Initiative started in late 2004, while some of the examinations were not completed until mid-2007 or early 2008, and three were still ongoing when we completed our fieldwork."[198]

For the 2006 election cycle, the IRS received 237 referrals, among which were 13 allegations that a church official had endorsed a political candidate during regular church services. The IRS selected 100 organizations for examination, including 44 churches. As of March 30, 2007, at which time only 40 examinations had been closed, the IRS had substantiated political intervention by, and had issued written advisories to, only 4 churches. In neither 2004 nor 2006 did the IRS revoke, or propose to revoke, the exempt status of a church.[199]

The IRS undertook another PACI for the 2008 2010 election cycles, but results have not yet been reported.

Issues for Consideration

Prior legislative proposals addressing the electioneering prohibition focused solely on churches. However, as discussed earlier, church status can be gamed. In addition,

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[197] Treasury Inspector General for Tax Administration, Statistical Profile of Alleged Political Intervention by Tax-Exempt Organizations in the 2004 Election Season (May 12, 2009)
[198] *Id.*
[199] Internal Revenue Service, 2006 Political Activities Compliance Initiative, *at* http://www.irs.gov/pub/irs-tege/2006paci_report_5-30-07.pdf

providing exceptions or separate rules for churches does not significantly reduce IRS's enforcement burden. We considered several ideas for reform of this provision but, again, lacked the expertise in constitutional law to make an informed recommendation. However, two ideas we believe would survive a constitutional challenge are:

1) Replace the prohibition with a limitation similar to the lobbying restrictions, or
2) Retain prohibition but define "Participate In" or "Intervene In" in terms of expenditures and electioneering communications per federal election law.