A. DEVELOPMENTS RELATING TO CHURCHES

1. Introduction

The Internal Revenue Service administration of the Internal Revenue Code provisions recognizing religious organizations as exempt from federal income tax is a matter of recurring interest to both the Service and the general public. In recognition of this interest, the 1980, 1981, and 1983 Continuing Professional Education texts contain discussions of the statutory and judicial bases for current Service policy in the area. This discussion will not repeat that material but rather will review particular developments occurring during 1983 that have an impact on the matters discussed in the earlier CPE texts.

2. Recent Litigation

The preceding year saw the addition of several more court decisions to the long line of precedents denying exemption and deductibility of contributions to mail-order ministries and similar "churches" established for tax avoidance purposes.

One of the more recent decisions, and one containing a particularly colorful judicial response to the use of a church as a means of tax avoidance, is Miedaner v. Commissioner, 81 T.C. No. 21 (Sept. 7, 1983). The case involves the taxation of royalty income to, and the deductibility of contributions to, the Church of Physical Theology, an organization described in the decision as nothing more than the alter ego of the founder. The evidence in the case demonstrated that the Church's founder had assigned the royalties from his book to the Church and that Church funds were used primarily to pay the Miedaners' living expenses. Except for nominal contributions (less than $100 total), all income to the Church came from the Miedaners. Typically, their contributions to the Church equaled the amount of expenses paid. Such expenses paid by the Church included dental bills, eyeglasses purchase, piano refinishing, exercise equipment purchases, and the purchase of an automobile radar detector. The Court concluded that the primary purpose of the Church was to promote the founder's book and pay his personal expenses and those of his wife. In its opinion, the Court described the scheme as "as transparent as a clear day in the Rocky Mountains" and that the taxpayers "kept shouting religion, religion, religion, but the Court kept hearing tax avoidance, tax avoidance, tax avoidance."

Similarly, in a case involving the uniquely named Ecclesiastical Order of the ISM of AM, Inc., the Tax Court found that an organization providing essentially a commercial tax service did not qualify for exemption under IRC 501(c)(3) or for classification as a church under IRC 509(a)(1) and IRC 170(b)(1)(A)(i). In its opinion, reported as The Ecclesiastical Order of the ISM of AM, Inc. v. Commissioner, 80 T.C. 833 (1983), the Court was careful to note that the nontraditional or unorthodox nature of the organization's beliefs was not an issue but that denial of exemption was based on the presence of a substantial nonexempt purpose and activity, the provision of tax advice. In its opinion, the Court referred to another recent decision, Bethel Conservative Mennonite Church v. Commissioner, 80 T.C. 352 (1983).

In Bethel, the Court held that a church was not operated exclusively for religious purposes during years in which it operated a medical aid plan for its members. The plan expenditures accounted for 22 percent of the organization's total disbursements and a substantial portion of the receipts. The medical plan was funded by contributions from the congregation and restricted its benefits to the congregation. While noting that the organization, without question, undertook religious activities of a traditional nature, the Court stated that if a church engages in a substantial nonexempt activity, it does not meet the operational test of IRC 501(c)(3) regardless of how substantial its religious or other exempt activities may be. The medical plan in this case was operated for the private benefit of the church members rather than for an exempt purpose.

There are a handful of deductibility cases that involve donations to "sham" churches. These are Jenny v. Commissioner, 45 T.C.M. 440 (1983); Mendenhall, T.C.M. 1983-491; and Davis v. Commissioner, 81 T.C. 49 (1983).

Finally, two other court cases of relevance to the church area involve the Church of Scientology of California and Bob Jones University. A discussion of these cases has been included in the discussion of public policy and exempt status in the CPE topic on private schools in this text.

3. Developments Relating to Church Examinations

Congress is currently considering several bills (H.R. 2172, H.R. 2977, and S. 1262) which would have the effect of amending IRC 7605(c), relating to the examination of churches. The proposed "Church Audit Procedures Act of 1983" (all three bills have the same name) would require that the Service "possess evidence" that a church is engaging in an unrelated trade or business or is no longer

undertaking exempt activities before beginning an investigation. Churches would have to be sent several notices outlining the nature of the investigation and the evidence possessed by the Service. Church examinations would be required to be completed within one year. The proposed legislation imposes a three year statute of limitations whether or not a church had filed a return and would also permit a church to seek a declaratory judgment on its exempt status upon notification by the Service of intention to revoke exemption or assess income tax on unrelated business taxable income. Churches would be permitted to obtain injunctions restraining the Service from further undertaking any audit activity which the churches claimed to be in violation of the new audit procedures. Hearings were held September 30, 1983, on the Senate version of the legislation by the Senate Finance Subcommittee on Oversight.

Church examinations were also the subject of a recent court decision. In Church of World Peace, Inc. v. I.R.S., 715 F. 2d 492 (10th Cir. 1983), a church attempted to prevent summary revocation of its exempt status through an injunction preventing further examination and a declaratory judgment that the Service was acting beyond its statutory and constitutional authority. The Service had attempted to obtain information on the organization's exempt status by letter but was unsuccessful. The organization then refused a written request to produce specific books and records. The Service issued a letter proposing revocation and holding that the organization had not exhausted its administrative remedies. The Court of Appeals affirmed a District Court refusal to grant either a declaratory judgment or an injunction on the basis that an adequate remedy at law existed should the Service revoke the organization's exempt status. Dicta in the opinion indicated that the Service could not summarily revoke the exempt status of a church based solely on the organization's refusal to submit information.

4. Churches and Political Activities

IRC 501(c)(3) provides, in part, that organizations organized and operated exclusively for religious purposes cannot participate in or intervene in (including the publishing or distributing of statements) any political campaign on behalf of any candidate for public office without jeopardizing their exempt status. The regulations, in sections 1.501(c)-1(c)(3)(i) and 1.501(c)(3)-1(c)(3)(iii), further define such proscribed political activity as the direct or indirect intervention or participation in any political campaign on behalf of or in opposition to any candidate for public office. The term "candidate for public office" means an individual who offers himself, or is proposed by others, as a contestant for an elective office, whether such office be national, state, or local. Activities which

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 candidates.

The predecessors to IRC 501(c)(3) prevented religious organizations from carrying on propaganda, or otherwise attempting, to influence legislation as a substantial part of their activities if they wished to be exempt from income tax. The present prohibition on political activities was included in IRC 501(c)(3) by Congress in an amendment proposed by then Senator Lyndon Johnson in 1954.

Since the 1954 legislation prohibiting intervention in political campaigns, a number of revenue rulings applicable to all IRC 501(c)(3 organizations have been issued by the Service in order to clarify those activities which would constitute such intervention.

In Rev. Rul. 67-71, 1967-1 C.B. 125, an organization supporting a particular slate of candidates for an elected school board was found to be intervening in political campaigns even though the exempt organization was attempting to evaluate the professional, rather than partisan, qualifications of the respective candidates.

In Rev. Rul. 74-574, 1974-2 C.B. 160, the Service determined that a religious and educational broadcasting station was not intervening in political campaigns when it made reasonable air time equally available (as then required by the Federal Communications Act of 1934, 47 U.S.C. sect. 312(a)(7)) to all legally qualified candidates for public office. The station, at the beginning and end of each broadcast, stated that the views expressed were those of the candidate and not the station.

Rev. Rul. 76-456, 1976-2 C.B. 151, concludes that an organization was not intervening in political campaigns where the organization drafted a code of fair campaign practices if it did not solicit the signing or endorsement of the code by candidates for public office. The revenue ruling does state that, if the organization solicits candidates to sign or endorse its code, it would be intervening in political campaigns.

Rev. Rul. 78-248, 1978-1 C.B. 154, states that the facts and circumstances of each case determine whether an organization is intervening in a political campaign. Two examples are provided which describe situations in which intervention did not occur. Both relate to organizations which provide a voters' guide on the positions

of the candidates on a wide variety of issues without any evidence, direct or indirect, of preference among the candidates. Two examples of political intervention are also provided. These examples describe voters' guides which evidence a bias, either through the types of questions asked, or through the limited subjects covered in the guide. Rev. Rul. 78-248 revoked Rev. Rul. 78-160, 1978-1 C.B. 153, which had taken a very strict approach to the types of activities an organization could engage in without intervening in a political campaign.

Rev. Rul. 78-248 was amplified by Rev. Rul. 80-282, 1980-2 C.B. 178, which stated that, in certain circumstances, a voters guide may be distributed, without intervening in a political campaign, even though it identifies the organization's position on the votes recorded in the voters guide. Factors indicating that the guide did not constitute intervention in a political campaign included the limited distribution of the guide to the publication's normal readership, inclusion of individuals not running for reelection, and no express or implied endorsements in the guide.

The case of Christian Echoes National Ministry, Inc. v. U. S., 470 F. 2d 849 (10th Cir. 1972), cert. denied, 414 U. S. 864 (1973), concerned political intervention, not in the form of an endorsement of a specific candidate, but in the form of attacks in publications and in broadcasts on candidates and incumbents considered too liberal by the religious organization. The Court held that the organization was not exempt under IRC 501(c)(3). The court also dismissed a claim by the organization that the IRC 501(c)(3) prohibition on political activities was an unconstitutional restriction on its freedom of speech. In doing so the court stated:

> In light of the fact that tax exemption is a privilege, a matter of grace rather than right, we hold that the limitations contained in section 501(c)(3) withholding exemption from nonprofit corporations do not deprive Christian Echoes of its constitutionally guaranteed right of free speech. The taxpayer may engage in all such activities without restraint, subject, however, to withholding of the exemption or, in the alternative, the taxpayer may refrain from such activities and obtain the privilege of exemption. ... The Congressional purposes evidenced by the 1934 and 1954 amendments are clearly constitutionally justified in keeping with the separation and neutrality principles particularly applicable in this case and, more succinctly, the principle that government shall not subsidize, directly or indirectly, those organizations whose substantial activities are directed toward

the accomplishment of legislative goals or the election or defeat or particular candidates.

The Service is now engaged in a controversial and highly visible law suit with potential constitutional impact in the areas of freedom of speech and the establishment of religion. At issue is alleged political activity by churches and church organizations exempt from federal income tax under IRC 501(c)(3).

Abortion Rights Mobilization, Inc. (ARM), along with several other organizations and individuals, is suing the Secretary of the Treasury and the Commissioner. It is the plaintiffs' position that the Service has knowingly permitted the Roman Catholic Church and some of its affiliates to engage in political activity on the issue of abortion; i.e., they allege that the Church has endorsed candidates for public office, passed out campaign literature and otherwise supported "pro-life" candidates in direct contravention of its exempt status under IRC 501(c)(3) and without incurring censure from the Service. The plaintiffs state that by permitting such activity, the Service has allowed a privilege to the Church not accorded to other IRC 501(c)(3) organizations and, thus, has violated the constitutional mandate for separation of church and state. The case is before the U. S. District Court for the Southern District of New York.

In a preliminary motion the Service challenged the plaintiffs' standing to sue. The Court, in Abortion Rights Mobilization, Inc. v. Regan, 552 Fed. Supp. 364 (S.D.N.Y. 1982), ruled against the Service. The case is currently in the discovery stage. The standing issue in this case is similar to the issue being litigated in Donald T. Regan et al. v. Inez Wright et al., 656 F. 2d 820 (D.D.C. 1981), S. Ct. Docket 81-970. See a discussion of the Wright case in the CPE topic on private schools in this text.

5. Conclusion

As the preceding discussion indicates, the topic of churches and federal income tax exemption is one of great interest and great sensitivity. Both pending litigation and pending legislation could have a dramatic impact on the Service's administration of the Code provisions applicable to such religious organizations.