

Letter to DOJ Confirms IRS Intent to Resume Church Tax Inquiries

August 11, 2014

In a June 27, 2014 [letter to the Department of Justice](#), the Acting Director of IRS Exempt Organizations Examinations revealed three potentially significant developments with respect to IRS enforcement activity against churches.

- ***There is a significant queue of approved church tax inquiries focused on alleged political activity.*** Specifically, the IRS' internal Political Activities Referral Committee "has determined that, as of June 23, 2014, 99 churches merit a high priority examination" because of alleged violations of the political intervention prohibition of section 501(c)(3). At least 66 of these cases relate to open tax years. It is unclear what will happen with these cases, because since 2013 the IRS has placed a temporary hold on proceeding with any new audits for political activities (church or non-church), in the wake of last year's controversy over its handling of conservative groups.
- ***IRS activity with regard to churches has continued and could increase significantly at any time.*** The IRS has not finalized its 2009 regulations identifying the IRS high-ranking official who must have a "reasonable belief" that the church may not be exempt or may have engaged in unrelated business activity before a church tax inquiry can commence. While early statements suggested that the IRS was suspending church audit activity until that official was identified, the letter clarifies that the IRS is proceeding with church audits, and has already "processed several cases involving churches" since 2009.
- ***Current procedures nominally elevate the "high ranking official" threshold to TEGE Commissioner.*** The statutorily-mandated "reasonable belief" determination has been internally assigned to the Commissioner, TEGE "either directly or as concurrence to the determination made by the Director, Exempt Organizations." This responds to public comments by requiring church tax inquiries to be approved at a higher level than the proposed regulations did, but still seems to anticipate active input into the decision from lower in the agency.

The letter came to light in connection with the recent [voluntary dismissal of *Freedom From Religion Foundation v. Commissioner*](#), a case that sought to enjoin the IRS from continuing a perceived policy of selective non-enforcement of the political activity prohibition of section 501(c)(3) against churches. The letter seems to have allayed the Foundation's concerns for now. However, by seeking dismissal without prejudice, the Foundation has preserved its ability to refile its claim, should the IRS resume audits of political activities but fail to include churches in such a program.

Caplin & Drysdale's Perspective

These statements send a clear signal that the Service is prepared to enforce its rules against churches, including its rules against campaign intervention. The letter may also signal that a compromise has been reached among IRS, Treasury and the Department of Justice regarding the level of the "high-ranking Treasury official" required to initiate a church tax inquiry. If so, final regulations under section 7611 may be forthcoming. For a detailed discussion of Section 7611, the *Living Word* decision and the proposed regulations, please see [our previous alert](#).

Steps to Take Now

We do not expect any new church audits regarding alleged campaign intervention to commence until the Service lifts its current hold on all political audits. Thereafter, those churches who have been trying to draw IRS enforcement so they can challenge the restrictions in court may finally get their opportunity. In the meantime, the IRS has clearly signaled its ability to audit on other issues at any time. For those groups that wish to avoid controversy with the IRS, now would be a good time to review your Church's books and records with an eye toward compliance. As the election season approaches, you may want to take special care that your activities—for instance, speaking out about issues relevant in the election, inviting elected officials or candidates to attend your events, and other voter education and engagement work—do not inadvertently cross the line into prohibited political campaign intervention. We would be happy to answer any questions.

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