



Caplin & Drysdale, Chartered
One Thomas Circle, NW, Suite 1100
Washington, DC 20005
202-862-5000 202-429-3301 Fax
www.caplindrysdale.com

202-862-5020 Direct
mso@capdale.com

July 17, 2006

Via Facsimile and Surface Mail

The Honorable Mark W. Everson
Commissioner
Internal Revenue Service
1111 Constitution Avenue, NW
Washington, DC 20224

J. Russell George
Treasury Inspector General for Tax Administration
Department of the Treasury
1125 15th Street, NW...
Washington, D.C. 20005

Re: IRS Delegations of Authority for IRC Section 7611

Dear Commissioner Everson:

I am writing on behalf of several churches concerned about the IRS's delegations of authority for Section 7611 of the Internal Revenue Code.¹ As you know, Section 7611 imposes certain procedural safeguards at the "church tax inquiry" stage in order to protect churches' First Amendment rights. We believe that the IRS has become overly casual in its interpretation of the statute, setting the stage for exactly the sort of invasive governmental action that Congress feared, and contributing to a recent apparent dramatic increase in the

¹ As used herein, all section references are to the Internal Revenue Code of 1986, as amended, unless otherwise noted. All references to regulations are to the Treasury Regulations promulgated thereunder.

number of church audits.² We respectfully request that you consider whether the IRS is appropriately delegating authority under Section 7611.

Section 7611 Entitles Churches to Unique Protections from Unnecessary Audits

For important First Amendment reasons, Congress has had an increased sensitivity to the tax administration of churches for years. In 1969, Congress enacted Section 7605(c) of the 1954 Internal Revenue Code, which provided that certain examinations of churches could only be conducted if an “officer no lower than principal internal revenue officer for an internal revenue region” believed the audit was appropriate. In 1984, Congress reiterated its concerns about IRS and churches when it broadened the protections for churches from unnecessary audits through enactment of Section 7611. Section 7611(a)(2) requires that, before initiating a church tax inquiry, an appropriate high-level Treasury Department official must reasonably believe (on the basis of facts and circumstances recorded in writing) that a church may not be tax-exempt under Section 501(a) or may be engaged in certain taxable activities. Section 7611(h)(7) defines “appropriate high-level Treasury official” as “the Secretary of the Treasury or any delegate of the Secretary whose rank is no lower than that of a principal Internal Revenue officer for an internal revenue region” (emphasis added). The Conference Report from the 1984 legislation specifically states:

the IRS may begin a church tax inquiry only if the IRS Regional Commissioner (or higher official) reasonably believes, on the basis of facts and circumstances recorded in writing, that the organization (1) may not qualify for tax exemption as a church, or (2) may be carrying on an unrelated trade or business...or be otherwise engaged in taxable activities.³ (Emphasis added)

After notice and opportunity for public comment, the Treasury Department and the IRS issued regulations in “question and answer” form, further interpreting Section 7611. Question 1 and its answer explicitly state that the IRS “may begin a church tax inquiry only when the appropriate Regional Commissioner (or higher Treasury official)” makes the “reasonable belief” determination (emphasis added). This formulation closely followed the legislative history of the provision and, without doubt, was of great comfort to those churches that analyzed the proposed regulations.

² For instance, the recent Political Activities Compliance Initiative Final Report provides that there were 47 investigations examinations of church political activity alone in 2004. Final Report at p. 9.

³ H.R. Conf. Rep. 98-861, 1101.

These procedures ensured that officials in a position to consider the broad policy implications of their actions would make the decision to initiate the inquiry, and this requirement is a key component of the set of the statutory safeguards that Congress enacted to ensure that churches are protected from overly intrusive IRS review. Because Section 7611 eliminates any appeals rights for churches, it is especially important that these decisions be made by high-level officials, who are appropriately removed from the normal audit process, to ensure that churches receive the protections Congress intended them to have.

At the time the statute was enacted and the regulations were promulgated, a Regional Commissioner was the highest level of career IRS employee, reporting directly to the Deputy Commissioner and Commissioner. A Regional Commissioner was far removed from day-to-day field activities and any audit decisions involving specific taxpayers. The references to Regional Commissioners, of course, no longer comport with the IRS's structure; however, the statute and regulations clearly provide for an alternative process—that a higher official make the decision, absent an opportunity for notice and public comment, including comment from the religious community, on any change to fix the appropriate official under the current IRS structure.

Despite the clear language requiring a high-level official to make the “reasonable belief” determination, the IRS has disregarded the language of the statute and the regulations. In a recently released memorandum, the IRS formalized what has apparently been an ongoing, informal delegation procedure and confirmed the assignment of the determination to the Director of EO Examinations. See ILM 200623061 (May 9, 2006) (the “ILM”). The IRS did not modify the regulations under Section 7611 or make any other adjustment of them that was subject to the public notice and comment procedures. Instead, the IRS used this ILM to justify a delegation occurring through the Internal Revenue Manual. See I.R.M. Section 4.76.7.4. This delegation is contrary to both the language and the intent of Section 7611. The Director of EO Examinations clearly is not a “principal” officer of the IRS, with duties and responsibilities comparable to those of a Regional Commissioner. Indeed, the Director of EO Examinations reports, not to the Commissioner, but to an official several levels below the Commissioner and has a relatively narrow area of responsibility, unlike a Regional Commissioner’s broad responsibility for all aspects of tax administration in a given region. Moreover, if the position of Director of EO Examinations were ever vacant, the position would likely be filled by personnel accustomed to operating at an even lower level in the organization. Conversely, if a Regional Commissioner position became vacant, another senior level official, familiar with policy matters, would have filled the vacancy. The implications of this change are striking: decisions regarding church tax inquiries are no longer being made by officials operating with a broad policy perspective; rather they are determined by an employee whose responsibility, by definition, only includes examination-related issues for a narrow class of organizations, namely those exempt from federal income tax, constituting a small fraction of all US taxpayers.

Of even greater concern, and a point which emphasizes the IRS's casual approach to the Constitutionally-critical task of church tax administration, is that the factual premise of the ILM is incomplete. The ILM assumes that the "reasonable belief" determination is being made by Director of EO Examinations, yet in a recently released internal memorandum, dated March 31, 2005, the Director of EO Examinations made an explicit delegation of the "reasonable belief" decision even lower within the IRS as part of the procedures for the IRS's Political Intervention Project. In an attachment to the memorandum entitled, "Political Intervention Procedures," a directive is set out that "the EO Referral Committee will make the determination... whether a reasonable belief exists under Section 7611." The EO Referral Committee is comprised of first-line technical employees in the EO Division including senior examiners, classification specialists and group managers.⁴ With all due respect to these employees, their positions within the agency are not those of "high-level Treasury officials," and thus the delegation of authority from the Director of EO Examinations down to the EO Referral Committee would seem to further contradict the Congressional intent of Section 7611. In fact, that is essentially the level at which routine decisions whether to examine any taxpayers are made.

Prior to the delegation of March 31, 2005, the IRS made another inappropriate delegation under Section 7611. We are aware of one authorization of an inquiry that was signed by an official named "LaPaula Davis" for Ms. Rosie Johnson, the Director of EO Examinations. It appears that Ms. Rosie Johnson signed a "designation" on October 26, 2004 through which she delegated to LaPaula Davis, Manager EPR, the authority to act as the Director of EO Examinations for the sole purpose of approving church tax inquiries and examinations under Section 7611, and not in any other capacity. I have attached a copy of this "designation" for your reference, as well as a redacted church inquiry letter signed by Ms. Davis in the exercise of her delegated authority. Given the unsystematic and sporadic way the preceding documents were released, there may well have been other delegations that have not been made public and which may even be unknown to senior IRS management.

The improper delegations under Section 7611 are contrary to other IRS policy regarding delegations

In contrast to the treatment of delegations under Section 7611, IRS Chief Counsel recently released a legal memorandum which appropriately concluded that the Treasury Secretary may not delegate the authority to make "good faith" exceptions under Section 903(d) of the American Jobs Creation Act of 2004 (the "AJCA Memorandum"). In the AJCA Memorandum, the IRS takes a rightfully narrow approach to the issue, construing both Section 7701(a) and two conflicting off-Code provisions to exclude delegation of the Secretary's

⁴ *Review of the Exempt Organizations Function Process for Reviewing Alleged Political Campaign Intervention by Tax Exempt Organizations*, February 17, 2005, at 12.

authority to sign waivers in that case. In particular, Chief Counsel focused its analysis on the fact that the plain language of the statute, calling for review by “the Secretary of the Treasury,” was unambiguous. Section 7611 of the Code, like Section 903(d) of the AJCA, unambiguously names the officials whom Congress intended should make the determination. In fact, Section 7611 provides even more guidance than Section 903(d) of the AJCA—Section 7611 enumerates the lowest level of permissible delegation. Moreover, unlike Section 903(d) of the AJCA, the legislative history relating to Section 7611 underscores Congress’s intent that high-level IRS officials make the “reasonable belief” determination.

Given that Section 7611(h)(7) limits the lowest permissible level of delegation, it is clear that a similarly literal approach as that taken by Chief Counsel in the AJCA Memorandum is appropriate in the case of church tax inquiries. The principles espoused in the AJCA Memorandum appear to conflict with both of the delegations of the Secretary’s “reasonable belief” determination in Section 7611 cases: (i) first, to the Director of EO Examinations who clearly is not a “principal” officer of the IRS, with duties and responsibilities comparable to those of a Regional Commissioner; and (ii) as part of the designation to relatively low-level technical employees in the EO Division.

We respectfully request that the IRS revisit the delegations under Section 7611

As you can see, my church clients are understandably concerned about the delegations that have occurred with respect to Section 7611. Moreover, we believe that all churches will be concerned about the erosion of these important procedural safeguards that Congress enacted to protect their First Amendment rights. Accordingly, we respectfully request that the IRS revisit the threshold “reasonable belief” determination at an appropriate high-level within the agency, as required by law and regulation, and reconsider whether a church tax inquiry is warranted in any of the ongoing inquiries and audits. If the “reasonable belief” determination has not been appropriately met, we request that the audits be suspended pending (1) a determination by the Commissioner, Deputy Commissioner or TE/GE Commissioner that a “reasonable belief” exists⁵ and (2) an appropriate modification of the existing Treasury Regulations to permit public comment on the appropriateness of the delegation to the Director of EO Examinations. Moreover, we request that the IRS not initiate any new church tax inquiries or examinations pending resolution of this issue unless the Commissioner, Deputy Commissioner or TE/GE Commissioner initiates them pursuant to the appropriate “reasonable belief” determination in order to ensure that due consideration is given to the First Amendment implications of the actions.

⁵ See Treas. Reg. § 301.7611-1, A. 17 (providing that violation of the rules under section 7611 will result in a stay on the proceedings pending the IRS’s correction of procedural flaws).

Sincerely,

A handwritten signature in black ink, appearing to read 'MSO', with a long horizontal flourish extending to the right.

Marcus. S. Owens

Enclosures



TAX EXEMPT AND
GOVERNMENT ENTITIES
DIVISION

DEPARTMENT OF THE TREASURY
INTERNAL REVENUE SERVICE
WASHINGTON, D.C. 20224

DEC 14 2004

Person to Contact:

Employee Identification Number:

Contact Telephone Number:

CERTIFIED MAIL

Dear Sir or Madam:

The Internal Revenue Service is responsible for administering the Internal Revenue laws of the United States, including those that apply to organizations exempt from federal income tax. To carry out that responsibility, section 7602 of the Internal Revenue Code (IRC) authorizes the Service to determine the correctness of any tax return, to make a return when none has been filed, and to determine the tax liability of any person or organization. However, IRC section 7611 imposes restrictions on the Service in conducting tax inquiries and examinations of churches and conventions or associations of churches.

In passing IRC section 7611, Congress intended to ensure that the Internal Revenue Service carry out its obligation to resolve questions concerning the tax liability, if any, and the tax-exempt status of churches and organizations claiming to be churches, with due regard for both the rights of church organizations and the responsibility of the Service to enforce the Internal Revenue laws.

Because a reasonable belief exists that

thereby jeopardizing its tax-exempt status as an organization under section 501(a), this letter is notice of the beginning of a church tax inquiry described under IRC section 7611(a). We are sending this letter because we believe it is necessary to resolve questions concerning the operations of the church, such as:

Our concerns are caused by the following information:

Section 501(c) (3) of the Code provides, in part, for the exemption from Federal income tax:

Organizations organized and operated exclusively for charitable, religious or educational purposes, no part of the net earnings of which inure to the benefit of any private shareholder or individual.

Section 1.501(c)(3)-1(d)(1)(ii) of the Regulations states that an organization is not operated exclusively for one or more exempt purposes unless it serves a public rather than a private interest. It must not be operated for the benefit of designated individuals or the persons who created it.

The presence of a single substantial nonexempt purpose can destroy the exemption regardless of the number or importance of exempt purposes. When an organization operates for the benefit of private interests, such as designated individuals, the creator or his family, or persons directly or indirectly controlled by such private interests, the organization by definition does not operate exclusively for exempt purposes.

IRC section 4958(c) (1) (A) defines the term "excess Benefit transaction" to mean 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.

IRC section 4958(f) (1) defines the term "disqualified person" to mean, with respect to any transaction (A) any person who was, at any time during the 5-year period ending on the date of such transaction, in a position to exercise substantial influence over the affairs of the organization, (B) a member of the family of an individual described in subparagraph (A), and (C) a 35-percent controlled entity. Section 4958(f) (2) defines the term "organization manager" to mean, with respect to any applicable tax-exempt organization, any officer, director, or trustee of such organization (or any individual having powers or responsibilities similar to those of officers, directors, or trustees of the organization).

A list of specific questions about your operations/activities is attached. Please answer each question completely. If your response resolves our concerns about your exempt status, it will not be necessary to pursue this matter further.

Attached as required by section 7611(a) (3) (B) (ii) is a statement of your administrative and constitutional rights during a tax inquiry and examination. Your rights include the right to a conference with Service representatives to discuss our concerns before the Service begins an examination. The Service will formally offer you the opportunity for a conference in the notice of examination, if a notice of examination is sent to you.

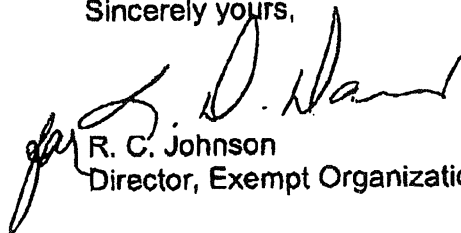
Please reply within 15 days of the date of this letter to:

If we do not hear from you within that time, we may issue a Notice of Church Examination letter, which section 7611 requires us to issue before we initiate an examination of your records or religious activities.

If you have any questions, please contact the person whose name and telephone number are shown above.

Thank you for your cooperation.

Sincerely yours,



R. C. Johnson
Director, Exempt Organizations Examinations

Enclosures: (2)

**INTERNAL REVENUE SERVICE
DESIGNATION**

LAPAULA DAVIS

(NAME)

IS DESIGNATED TO ACT AS:

DIRECTOR, EO EXAMINATIONS

(TITLE OF POSITION)

FROM:

OCTOBER 26, 2004

TO:

DECEMBER 31, 2004

REMARKS:

LIMITED TO SIGNATURE AUTHORITY ON MATTERS RELATING TO CHURCH TAX INQUIRIES
AND/OR CHURCH TAX EXAMINATION AS DEFINED IN IRC 7611.

SIGNATURE:

R. C. Johnson

DATE:

10/26/04

TITLE:

Director, EO Examinations

COPY TO:

EO Area Managers

Director, EO

DEPARTMENT OF THE TREASURY - INTERNAL REVENUE SERVICE

Lapaula is Mgr of Exam, Programs, & Review