

[4830-01-p]

DEPARTMENT OF THE TREASURY

Internal Revenue Service

26 CFR Part 301

[REG-112756-09]

RIN 1545-BI60

Amendments to the Regulations Regarding Questions and Answers Relating to Church Tax Inquiries and Examinations

AGENCY: Internal Revenue Service ("IRS"), Treasury.

ACTION: Notice of proposed rulemaking.

SUMMARY: This document contains proposed regulations amending the questions and answers relating to church tax inquiries and examinations. These proposed regulations replace references to positions that were abolished by the Internal Revenue Service Restructuring and Reform Act of 1998 with references that are consistent both with the statute and the IRS's current organizational structure.

DATES: Written or electronic comments and requests for a public hearing must be received by **[INSERT DATE THAT IS 90 DAYS AFTER PUBLICATION OF THIS DOCUMENT IN THE FEDERAL REGISTER]**.

ADDRESSES: Send submissions to: CC:PA:LPD:PR (REG-112756-09), room 5205, Internal Revenue Service, PO Box 7604, Ben Franklin Station, Washington, DC 20044. Submissions may be hand-delivered Monday through Friday between the hours of 8 a.m. and 4 p.m. to CC:PA:LPD:PR (REG-112756-09), Courier's Desk, Internal Revenue Service, 1111 Constitution Avenue, NW, Washington, DC, or sent electronically, via the Federal eRulemaking Portal at [www.regulations.gov](http://www.regulations.gov) (IRS-REG-112756-09).

FOR FURTHER INFORMATION CONTACT: Concerning these proposed regulations, Benjamin Akins at (202) 622-1124 or Monice Rosenbaum at (202) 622-6070; concerning submission of comments and requests for a public hearing, Richard Hurst, [Richard.A.Hurst@irs.counsel.treas.gov](mailto:Richard.A.Hurst@irs.counsel.treas.gov), (202) 622-7180 (not a toll-free numbers).

SUPPLEMENTARY INFORMATION:

## **Background**

### Restrictions on Church Tax Inquiries and Examinations

This document contains amendments to the regulations on Procedure and Administration (26 CFR part 301) under section 7611 of the Internal Revenue Code. Section 7611 was enacted by section 1033 of the Deficit Reduction Act of 1984 (Public Law 98-369, 98 Stat. 1034-1039) ("DRA 1984").

Prior to the enactment of section 7611, section 7605(c) imposed special requirements that the IRS had to meet before it could examine church books of account, but there were no special requirements imposed before the IRS could commence an investigation or inquiry into a church's tax liabilities. As explained in the Conference Report accompanying DRA 1984, H.R. Rep. No. 98-861, 98th Cong., 2d Sess. 1101 (1984), 1984-3 CB Vol. 2 355, Congress sought to address certain problems that arise when the IRS examines the records of a church. Thus, Congress expanded the requirements relating to IRS interactions with churches. Although prior law imposed limitations on the examination of church records, those limitations were somewhat vague and relied on internal IRS procedures to protect the rights of a church in the examination process. Additionally, there was some uncertainty regarding the scope of the investigations to which prior law applied and the nature of the records protected by

the law. The enactment of section 7611 attempted to resolve these competing considerations by providing detailed rules for the IRS to follow in making tax inquiries to churches, both as to tax-exempt status and as to the existence of unrelated business income.

Section 7611(a)(2) permits the IRS to begin an inquiry into whether a church qualifies for exemption from income tax as an organization described in section 501(c)(3) or whether a church has a liability for unrelated business income tax only if an appropriate high-level Treasury official first reasonably believes on the basis of facts and circumstances, recorded in writing, that the church may not be exempt under section 501(a), or that the church may be carrying on an unrelated trade or business, or may be otherwise engaged in activities subject to tax. Section 7611(h)(7) provides that the term "appropriate high-level Treasury official" means 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. The legislative history of section 7611 interprets the term "appropriate high-level Treasury official" to mean an IRS Regional Commissioner (or higher official). H.R. Rep. No. 98-861, 98th Cong. 2d Sess. 1101 (1984), 1984-3 CB Vol. 2 355. Final regulations under section 7611, which were published on February 21, 1986, 50 Fed. Reg. 6219, also interpret the term to mean an IRS Regional Commissioner. See Treas. Reg. §301.7611 Q1-A1.

Section 7611(b)(2)(A) provides that at least 15 days before the beginning of a church tax examination, the IRS must provide notice of the examination to both the church and the appropriate regional counsel. Section 7611(b)(3)(C) provides that any regional counsel who receives notice under section 7611(b)(2)(A) may submit to a

regional commissioner an advisory objection to the examination within 15 days after the notice of examination is provided.

Section 7611(c)(1)(A) provides that the IRS must make a final determination as to any church tax inquiry or examination within two years of the date the notice of examination is provided to the church under section 7611(b). In instances where no examination follows a church tax inquiry, section 7611(c)(1)(B) requires the IRS to make a final determination as to the inquiry no later than 90 days after the date the notice of inquiry is provided to the church under section 7611(a). Section 7611(c)(2) suspends the periods described in section 7611(c)(1) (that is, 2 year period and 90 day period) while certain judicial proceedings are pending or being appealed, including proceedings brought by the IRS against a church seeking to compel compliance with a reasonable request to examine church records or religious activities.

Section 7611(d)(1) prohibits the IRS from making certain final determinations (that is, revocation of tax-exempt status, notice of deficiency, or assessment) regarding a church until after the appropriate regional counsel determines in writing that there has been substantial compliance with the requirements of section 7611. Section 7611(d)(1) further requires the appropriate regional counsel's written approval of such final determination before the IRS can make the determination.

Section 7611(e)(1) provides that if the IRS has not substantially complied with the requirements of section 7611, any proceeding to compel compliance with a summons shall be stayed until the court finds that the IRS has taken all practicable steps to correct the noncompliance. Section 7611(e)(2) states that the remedy provided

in subsection (e)(1) shall be the exclusive remedy for a church in regard to any noncompliance by the IRS with the requirements of section 7611.

Under section 7611(f), the IRS may not commence an inquiry or examination of a church if, within the previous five years, the IRS completed an inquiry or examination regarding the church that did not result in a revocation, notice of deficiency, assessment, or a request for a significant change in the church's operating practices. An exception exists where the Secretary or his delegate approves the second inquiry or examination in writing. There is also an exception where the issues involved in the subsequent inquiry or examination are not the same or similar to issues involved in the preceding inquiry or examination. Prior to the Internal Revenue Service Restructuring and Reform Act of 1998, Public Law 105-206 ("RRA 1998"), discussed below, section 7611(f) required the Assistant Commissioner (Employee Plans and Exempt Organizations), instead of the Secretary or his delegate, to approve subsequent inquiries and examinations for the exception to apply.

### Reorganization of the IRS

Section 1001 of RRA 1998 requires the Commissioner of Internal Revenue to develop and implement a plan to reorganize the IRS. The congressional mandate provides that the plan shall "eliminate or substantially modify the existing organization of the IRS which is based on a national, regional, and district structure; [and] establish organizational units serving particular groups of taxpayers with similar needs . . . ." Under the reorganized IRS, four nationwide operating divisions were established to serve different types of taxpayers. One of these operating divisions serves tax exempt and government entities, including churches.

Section 1102(e)(3) of RRA 1998 amended section 7611(f)(1), relating to second inquiries and examinations within five years of a previous inquiry or examination, by replacing Assistant Commissioner (Employee Plans and Exempt Organizations) with Secretary. Under section 7701(a)(11)(B), Secretary is defined to refer to the Secretary of the Treasury or his delegate. RRA 1998 did not amend other portions of section 7611, such as references to "appropriate high-level Treasury official" and "appropriate regional counsel."

In mandating the restructuring of the IRS under RRA 1998, Congress realized that certain positions within the IRS would be eliminated as a result of transitioning from a geographic structure to a structure based on nationwide jurisdiction of similar types of taxpayers. Accordingly, Congress included a savings provision in RRA 1998. Section 1001(b) provides, "All orders, determinations, rules, regulations . . . and other administrative actions . . . which are in effect at the time this section takes effect . . . shall continue in effect according to their terms until modified, terminated, superseded, set aside or revoked in accordance with law by . . . the Secretary of the Treasury [or] the Commissioner of Internal Revenue . . . ." This provision keeps in effect regulations that make reference to officers whose positions no longer exist. The legislative history of RRA 1998 at H.R. Conf. Rep. No. 105-599, 105th Cong., 2d Sess. 195 (1998) explains that "[t]he legality of IRS actions will not be affected pending further appropriate statutory changes relating to such a reorganization (e.g., eliminating statutory references to obsolete positions)." Accordingly, the Treasury Regulations under section 7611 have remained in effect notwithstanding their references to the positions of Regional Commissioner, Regional Counsel, and Assistant Commissioner (Employee

Plans and Exempt Organizations), positions that were eliminated by the reorganization. Delegation Order 193 (Rev. 6) (11/08/2000) provides in part that actions previously delegated to Regional Commissioners by Treasury Regulations (par. 7) are now delegated to "Assistant Deputy Commissioners, Division Commissioners; Chiefs; and Directors, Submission Processing Field, Compliance Services Field, and Accounts Management Field." In the Internal Revenue Manual ("IRM"), the IRS designated the Director, Exempt Organizations Examinations as the appropriate high-level Treasury official for purposes of section 7611. See IRM § 4.76.7.

Recent litigation has challenged the IRS's interpretation of the term "appropriate high-level Treasury official" following the reorganization. See United States v. Living Word Christian Center, Civil No. 08-mc-37, D.C. Minn. (Jan. 30, 2009) ("LWCC"). In particular, concern has been expressed about the need for an update to the regulations in light of the statutorily mandated reorganization and the elimination of internal revenue regions.

In LWCC, the District Court for the District of Minnesota ruled that the Director, Exempt Organizations Examinations is not an appropriate high-level Treasury official to make the "reasonable belief" determination required before the IRS may commence a church tax inquiry under section 7611. LWCC at 2. The district court concluded that the Director, Exempt Organizations Examinations is not an appropriate high-level Treasury official within the meaning of section 7611(h) because that official does not have a comparable breadth of responsibility to a regional commissioner nor as high a position within the IRS. Although the IRS disagrees with the district court's reasoning and conclusion in LWCC, the IRS acknowledges that it would be beneficial to revise the

regulations in light of the changes in IRS organization made in the wake of RRA 1998 to clarify who is an appropriate high-level Treasury official for purposes of section 7611. Further, the IRS recognizes the significance of the special procedural requirements for church tax inquiries and examinations. These proposed regulations assign responsibility for making the determinations required under section 7611(a) to the Director, Exempt Organizations.

### **Explanation of Provisions**

These proposed regulations eliminate references to the positions of Regional Commissioner and Regional Counsel under the existing regulations and give responsibilities formerly assigned to these now defunct positions to the Director, Exempt Organizations and the Division Counsel / Associate Chief Counsel, Tax Exempt and Government Entities, respectively. In addition, these proposed regulations eliminate references to the position of Assistant Commissioner (Employee Plans and Exempt Organizations) under the existing regulations and give responsibilities formerly assigned to that position to the Commissioner, Tax Exempt and Government Entities or the Deputy Commissioner, Tax Exempt and Government Entities.

### **Reasonable Belief and Inquiry Notice Requirement**

With respect to the initiation of the church tax inquiry process, Treas. Reg. §301.7611-1 Q1-A1 provides that a "Regional Commissioner (or higher Treasury official)" is the appropriate high-level Treasury official for purposes of this reasonable belief requirement. Similarly, Treas. Reg. §301.7611-1 Q7-A7 states, "Repeated (two or more) failures by a church or its agents to reply to routine requests . . . will be considered by the appropriate Internal Revenue Service Regional Commissioner to be a

reasonable basis for commencement of a church tax inquiry under the church tax inquiry and examination procedures of section 7611." In addition, Treas. Reg. §301.7611 Q9-A9 requires a Regional Commissioner to provide written notice to the church of the beginning of an inquiry.

These proposed regulations eliminate references to the Regional Commissioner and instead provide that the Director, Exempt Organizations is the "appropriate high-level Treasury official" for purposes of the reasonable belief and inquiry notice requirements of Treas. Reg. §301.7611-1 Q1-A1, Q7-A7, and Q9-A9.

The Director, Exempt Organizations is a senior executive who reports to the Commissioner / Deputy Commissioner, Tax Exempt and Government Entities Division, and who is responsible for planning, managing, directing and executing nationwide activities for Exempt Organizations. See IRM §1.1.23.5 for a comprehensive description of these activities.

#### Examination Notice Requirement

Under section 7611(b)(2) and Treas. Reg. §301.7611-1 Q10-A10, a church tax examination cannot be commenced without first providing written notice of such examination to the church and to the "appropriate Regional Counsel" at least 15 days before the IRS begins the church tax examination. The regulation allows the Regional Counsel to file an advisory objection to the examination within this same 15-day period.

These proposed regulations amend Treas. Reg. §301.7611-1 Q10-A10 by substituting Division Counsel / Associate Chief Counsel, Tax Exempt and Government Entities, for each occurrence of Regional Counsel. These proposed regulations further specify that before the notice of examination is provided to the church, a copy of the

notice must be provided to the Division Counsel / Associate Chief Counsel, Tax Exempt and Government Entities.

#### Revocation of Exemption or of Church Status

Section 7611(d)(1) and Treas. Reg. §301.7611-1 Q11-A11 require the Regional Counsel to approve, in writing, certain final determinations that are within the scope of section 7611 and adversely affect the tax-exempt status or increase any tax liability of a church. Further, prior to such adverse action, section 7611(d) requires Regional Counsel to determine, in writing, that there has been substantial compliance with the requirements of section 7611, when applicable.

These proposed regulations amend Treas. Reg. §301.7611-1 Q11-A11 by providing that the Division Counsel / Associate Chief Counsel, Tax Exempt and Government Entities, is the official responsible for complying with the written determination and approval requirements of section 7611(d)(1).

#### Limitations on Period of Assessment

Section 7611(d)(2) and Treas. Reg. §301.7611-1 Q15-A15 provide special limitation periods for church tax liabilities. These special rules are not to be construed to increase an otherwise applicable limitation period. Treas. Reg. §301.7611-1 Q15-A15 states that, for purposes of section 7611(d)(2)(A), that is, the statute of limitations applicable to liabilities arising from church tax examinations, a church is determined not to be a church exempt from tax when the appropriate Regional Commissioner approves, in writing, the completed findings of the examining agent that the organization is not a church exempt from tax for one or more of the three most recently completed taxable years ending before the examination notice date. The regulation also states

that the Regional Commissioner cannot delegate this approval to a subordinate official. Further, the completed findings of the examining agent, which are approved by the appropriate Regional Commissioner, are not considered a final revenue agent's report (defined in section 7611(g)).

These proposed regulations substitute the Director, Exempt Organizations for the appropriate Regional Commissioner for purposes of Treas. Reg. §301.7611-1 Q15-A15.

#### Multiple Examinations

Consistent with the language of section 7611(f)(1) prior to enactment of RRA 1998, Treas. Reg. §301-7611-1 Q16-A16 provides that the Assistant Commissioner (Employee Plans and Exempt Organizations) is responsible for providing the written approval necessary to begin a second inquiry or examination of a church. These proposed regulations provide that the Commissioner, Tax Exempt and Government Entities or the Deputy Commissioner, Tax Exempt and Government Entities is responsible for approving second inquiries and examinations under section 7611(f).

#### Remedies for Violation of Section 7611

Section 7611(e) and Treas. Reg. §301.7611-1 Q17-A17 provide that, if there has not been substantial compliance with certain requirements in section 7611, including the notice requirements of section 7611(a) and (b), the exclusive remedy for such noncompliance is a stay in an enforcement proceeding to compel compliance with a summons with respect to the inquiry or examination. The stay continues until the court finds that all practicable steps to correct the noncompliance have been taken. Treas. Reg. §301.7611-1 Q17-A17 further states that failure of the Regional Commissioner to approve an inquiry may not be raised as a defense or as an affirmative ground for relief

in a summons proceeding or any other judicial proceeding other than as specifically set forth in the regulation.

These proposed regulations amend Treas. Reg. §301.7611-1 Q17-A17 to replace each reference to Regional Commissioner with Director, Exempt Organizations.

### **Special Analyses**

It has been determined that this notice of proposed rulemaking is not a significant regulatory action as defined in Executive Order 12866. Therefore, a regulatory assessment is not required. It has also been determined that section 553(b) of the Administrative Procedure Act (5 U.S.C. chapter 5) does not apply to these proposed regulations and because the regulation does not impose a collection of information on small entities, the Regulatory Flexibility Act (5 U.S.C. 601) does not apply.

Pursuant to section 7805(f) of the Code, these proposed regulations have been submitted to the Chief Counsel for Advocacy of the Small Business Administration for comment on its impact on small business.

### **Comments and Requests for a Public Hearing**

Before these proposed regulations are adopted as final regulations, consideration will be given to any written comments (a signed original and eight (8) copies) or electronic comments that are submitted timely to the IRS. Comments are requested on all aspects of the proposed regulations. All comments will be available for public inspection and copying. A public hearing will be scheduled if requested in writing by any person that timely submits written or electronic comments. If a public hearing is

scheduled, notice of the date, time, and place for the public hearing will be published in the **Federal Register**.

### **Drafting Information**

The principal authors of these proposed regulations are Benjamin Akins and Monice Rosenbaum of the Office of Division Counsel / Associate Chief Counsel (Tax Exempt and Government Entities). However, other personnel from the IRS and the Treasury Department participated in their development.

### **List of Subjects 26 CFR Part 301**

Administrative practice and procedure, Bankruptcy, Courts, Crime, Employment taxes, Estate taxes, Excise taxes, Gift taxes, Income taxes, Investigations, Law enforcement, Penalties, Pensions, Statistics, Taxes, Disclosure of information, Filing requirements.

## Amendments to the Regulations.

Accordingly, 26 CFR part 301 is proposed to be amended as follows:

### PART 301—PROCEDURE AND ADMINISTRATION

Paragraph 1. The authority citation for part 301 continues to read in part as follows:

Authority: 26 U.S.C. 7805 \* \* \*

Par. 2. In §301.7611-1, each entry in the table, undesignated paragraphs in the “Old Paragraph” column are designated as new paragraphs in the “New Paragraph” column to read as follows:

Old Paragraph	New Paragraph
§301.7611-1 A-5 first undesignated paragraph	§301.7611-1 A-5 paragraph (a)
§301.7611-1 A-5 second undesignated paragraph	§301.7611-1 A-5 paragraph (b)
§301.7611-1 A-6 first undesignated paragraph	§301.7611-1 A-6 paragraph (a)
§301.7611-1 A-9 first undesignated paragraph	§301.7611-1 A-9 paragraph (a)
§301.7611-1 A-9 second undesignated paragraph	§301.7611-1 A-9 paragraph (b)
§301.7611-1 A-10 first undesignated paragraph	§301.7611-1 A-10 paragraph (a)
§301.7611-1 A-10 second undesignated paragraph	§301.7611-1 A-10 paragraph (b)
§301.7611-1 A-10 third undesignated paragraph	§301.7611-1 A-10 paragraph (c)
§301.7611-1 A-10 fourth undesignated paragraph	§301.7611-1 A-10 paragraph (d)
§301.7611-1 A-10 fifth undesignated paragraph	§301.7611-1 A-10 paragraph (e)

§301.7611-1 A-11 first undesignated paragraph	§301.7611-1 A-11 paragraph (a)
§301.7611-1 A-11 second undesignated paragraph	§301.7611-1 A-11 paragraph (b)
§301.7611-1 A-11 third undesignated paragraph	§301.7611-1 A-11 paragraph (c)
§301.7611-1 A-13 first undesignated paragraph	§301.7611-1 A-13 paragraph (a)
§301.7611-1 A-13a first undesignated paragraph	§301.7611-1 A-13a paragraph (a)
§301.7611-1 A-14 first undesignated paragraph	§301.7611-1 A-14 paragraph (a)
§301.7611-1 A-14 second undesignated paragraph	§301.7611-1 A-14 paragraph (b)
§301.7611-1 A-15 first undesignated paragraph	§301.7611-1 A-15 paragraph (a)
§301.7611-1 A-15 second undesignated paragraph	§301.7611-1 A-15 paragraph (b)
§301.7611-1 A-15 third undesignated paragraph	§301.7611-1 A-15 paragraph (c)
§301.7611-1 A-15 fourth undesignated paragraph	§301.7611-1 A-15 paragraph (d)
§301.7611-1 A-15 fifth undesignated paragraph	§301.7611-1 A-15 paragraph (e)
§301.7611-1 A-15 sixth undesignated paragraph	§301.7611-1 A-15 paragraph (f)
§301.7611-1 A-15 seventh undesignated paragraph	§301.7611-1 A-15 paragraph (g)
§301.7611-1 A-16 first undesignated paragraph	§301.7611-1 A-16 paragraph (a)

§301.7611-1 A-17 first undesignated paragraph	§301.7611-1 A-17 paragraph (a)

**§301.7611-1 [Amended]**

Par. 3. For each section listed in the table, remove the language in the “Remove” column and add in its place the language in the “Add” column as set forth below:

<u>Section</u>	<u>Remove</u>	<u>Add</u>
§301.7611-1 A-1 first sentence	appropriate Regional Commissioner (or higher Treasury official)	Director, Exempt Organizations
§301.7611-1 A-7 first sentence	appropriate Internal Revenue Service Regional Commissioner	Director, Exempt Organizations
§301.7611-1 A-9 first sentence	appropriate Regional Commissioner	Director, Exempt Organizations
§301.7611-1 A-10 first sentence	appropriate Regional Counsel	Division Counsel/Associate Chief Counsel, Tax Exempt and Government Entities
§301.7611-1 A-10 paragraph (b) first sentence	At the time the notice of examination (second notice) is provided to the church, a copy of the same notice will be provided to the appropriate Regional Counsel.	Before the notice of examination (second notice) is provided to the church, a copy of the same notice will be provided to the Division Counsel / Associate Chief Counsel, Tax Exempt and Government Entities.
§301.7611-1 A-10 paragraph (b) second sentence	Regional Counsel	Division Counsel/Associate Chief Counsel, Tax Exempt and Government Entities
§301.7611-1 A-11 paragraph (c) first, second and third sentences	Regional Counsel	Division Counsel/Associate Chief Counsel, Tax Exempt and Government Entities

§301.7611-1 A-15 paragraph (c) first and third sentences	appropriate Regional Commissioner	Director, Exempt Organizations
§301.7611-1 A-15 paragraph (c) second sentence	Regional Commissioner	Director, Exempt Organizations
§301.7611-1 A-16  first sentence	Assistant Commissioner (Employee Plans and Exempt Organizations)	Commissioner, Tax Exempt and Government Entities or the Deputy Commissioner, Tax Exempt and Government Entities
§301.7611-1 A-16  second sentence	Assistant Commissioner's approval	approval of the Commissioner, Tax Exempt and Government Entities or the Deputy Commissioner, Tax Exempt and Government Entities
§301.7611-1 A-16 paragraph (a) second sentence	Assistant Commissioner (Employee Plans and Exempt Organizations)	Commissioner, Tax Exempt and Government Entities or the Deputy Commissioner, Tax Exempt and Government Entities
§301.7611-1 A-17 first sentence	Regional Commissioner	Director, Exempt Organizations
§301.7611-1 A-17 paragraph(a) third sentence	Regional Commissioner	Director, Exempt Organizations
§301.7611-1 A-17 paragraph (a) fourth sentence	appropriate Regional Commissioner's belief	belief of the Director, Exempt Organizations

Linda E. Stiff

Deputy Commissioner for Services and Enforcement.

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