

**WHY CONGRESS ADOPTED THE CHURCH AUDIT
PROCEDURES ACT AND WHAT MUST BE DONE NOW TO
RESTORE THE LAW FOR CHURCHES AND THE IRS**

*J. Michael Martin **

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* Legal Counsel, ECFA (Evangelical Council for Financial Accountability). B.S., Government, Oral Roberts University; J.D., Regent University School of Law. This Article is dedicated to my dear friends and mentors at ECFA, Dan Busby and John Van Drunen. Thank you for giving me the great privilege of learning and serving with you; I am forever grateful.

I. INTRODUCTION

This year, the Church Audit Procedures Act (“CAPA”)¹ turns thirty, but no one is celebrating. A technicality in the law left unresolved by Congress and the Treasury Department for several years now prevents CAPA from being properly administered to serve its intended purpose of protecting churches and the IRS in the course of church tax inquiries and examinations.

CAPA was enacted in an environment—not unlike today—when trust in the Internal Revenue Service (“IRS”) had plummeted. While there was no such thing back then as the Tea Party movement or viral videos of IRS employees spoofing *Star Trek* and dancing to the Cupid Shuffle,² there were serious concerns mounting at the time over poorly executed and allegedly abusive IRS audits of houses of religious worship—an already sensitive area of tax enforcement given the constitutional limitations of the First Amendment.³

These concerns peaked in the early 1980s, resulting in a broad, bipartisan effort to establish clearer statutory guidance that would protect the interests of both religious organizations and the IRS.⁴ Codified as

1. Church Audit Procedures Act of 1984, Pub. L. No. 98-369, § 1033(a), 98 Stat. 494 [hereinafter CAPA].

2. The IRS became embroiled in major national controversy in mid-2013 following two reports issued by the Treasury Inspector General for Tax Administration. The first involved inappropriate handling of tax-exempt applications by groups identified with the Tea Party and other conservative causes. See TREASURY INSPECTOR GENERAL FOR TAX ADMINISTRATION, INAPPROPRIATE CRITERIA WERE USED TO IDENTIFY TAX-EXEMPT APPLICATIONS FOR REVIEW (May 14, 2013), available at <http://www.treasury.gov/tigta/auditreports/2013reports/201310053fr.pdf>; see also Fred Stokeld et al., *EO Scandal Rocks IRS*, 71 EXEMPT ORGANIZATION TAX REVIEW 595 (2013). The second surrounded the IRS’s questionable use of taxpayer dollars for conference expenses, including the production of costly training videos showing IRS employees spoofing *Star Trek* and line dancing to the “Cupid Shuffle.” See TREASURY INSPECTOR GENERAL FOR TAX ADMINISTRATION, REVIEW OF THE AUGUST 2010 SMALL BUSINESS/SELF-EMPLOYED DIVISION’S CONFERENCE IN ANAHEIM, CALIFORNIA (May 31, 2013), available at www.treasury.gov/tigta/auditreports/2013reports/201310037fr.pdf; see also Ed O’Keefe, *IRS Training Videos Spoof ‘Star Trek,’ ‘Gilligan’s Island’ and ‘Cupid Shuffle,’* WASH. POST (June 1, 2013, 1:14 PM), <http://www.washingtonpost.com/blogs/post-politics/wp/2013/06/01/irs-training-videos-spoof-star-trek-gilligans-island-and-cupid-shuffle/>.

3. See generally *Church Audit Procedures Act: Hearing Before the Subcomm. on Oversight of the I.R.S. of the S. Comm. on Finance*, 98th Cong. (1983) [hereinafter *Hearing*].

4. *Id.* at 1–3 (statement of Sen. Charles Grassley, Chairman, Subcomm. on Oversight of the I.R.S. of the S. Comm. on Fin.); *id.* at 13–25 (statement of Rep. Mickey Edwards); see also, e.g., Leslie S. Garthwaite, *An End to Politically Motivated Audits of Churches? How Amendment to Section 7217 Can Preserve Integrity in the Tax Investigation of Churches Under Section 7611*, 60 TAX LAWYER 503, 503–04 (2007) (“The procedural requirements of section 7611 purport to protect

section 7611 of the Internal Revenue Code, CAPA sets forth specific and heightened procedural processes for the IRS to follow when auditing churches for federal income tax compliance.⁵ These procedures help to preserve the proper degree of separation of church and state required under the First Amendment and allow the IRS to shield itself against possible criticisms for haphazardly intruding into the sensitive area of reviewing church records and activities.⁶

CAPA proved to be a very useful and widely accepted solution to these concerns for many years after it was adopted.⁷ However, a technical issue left unresolved by Congress and the Treasury Department after the IRS reorganization in 1998 concerning who is an “appropriate high-level Treasury official” to initiate church tax inquiries and examinations has severely weakened CAPA’s effectiveness, as brought to light in high-profile litigation between a Minnesota church and the IRS in *United States v. Living Word Christian Center*.⁸ This, in turn, has spurred further controversy as the IRS seems virtually unwilling to conduct income tax audits of churches for the time being.⁹ As if this sorry state of affairs alone was not enough motivation to resolve the lingering technical issue required to restore CAPA, the recent controversy over the IRS’s admittedly inappropriate handling of tax-exempt applications based on perceived political affiliation¹⁰ is a timely reminder of why the procedures

churches against violations of their First Amendment rights as well as protection from arbitrary and capricious harassment. As such, section 7611 is important to maintaining confidence in the Service and its honor-based reporting. Section 7611 also is the source of important guidance to Service employees who need clarity to guide them in handling allegations of improper activities by tax exempt entities.”)

5. I.R.C. § 7611 (2012).

6. See discussion *infra* Part II.

7. In fact, CAPA has gone largely without controversy and virtually without consideration by legal scholars over its thirty-year history. As of this Article’s publication, the author and this journal’s editors have been unable to identify any other comprehensive legal scholarship focused squarely on issues involving the church audit procedures of section 7611.

8. See discussion *infra* Part III.

9. David van de Berg, *IRS Management Turnover Exacerbates EO Guidance Delays*, 73 EXEMPT ORGANIZATION TAX REVIEW 15, 16 (2014); Paul Streckfus, *Simultaneous Release of 2013-2014 Priority Guidance Plan and Fourth Quarter Update to the 2012-2013 Priority Guidance Plan*, EO TAX JOURNAL 2013-145 (Aug. 13, 2013), <http://eotaxjournal.com/eotj/?p=2670>; John Burnett, *Can a Television Network Be a Church? The IRS Says Yes*, NPR (Apr. 1, 2014), <http://www.npr.org/2014/04/01/282496855/can-a-television-network-be-a-church-the-irs-says-yes>; *Church Tax Audits Not Moving for Lack of Final Rules*, BLOOMBERG BNA (Oct. 22, 2012), <http://www.bna.com/church-tax-audits-n17179870390/>; Erik Stanley, *Has The IRS Given Up on Auditing Churches?*, ALLIANCE DEFENDING FREEDOM (Nov. 3, 2012), <http://blog.speakupmovement.org/church/churches-and-politics/has-the-irs-given-up-on-auditing-churches/>. A federal lawsuit by the Freedom From Religion Foundation against the IRS seeks to press the matter. See *Freedom From Religion Foundation, Inc. v. Comm’r*, 12-CV-818 (W.D. Wis. Nov. 14, 2012).

10. On May 10, 2013, Lois Lerner, then-Director of Exempt Organizations for the IRS, issued

of section 7611 should be restored to insulate the agency from similar criticisms related to its oversight of tax compliance by religious institutions.¹¹

This Article explores the significant policy purposes achieved by CAPA through the lens of the law's history and present challenges. Part II reviews the historical context and events leading to the adoption of CAPA in 1984. Part III then describes the present challenges associated with the law due to the failure of Congress and the Treasury Department to rectify the issue of who is an appropriate high-level Treasury official under CAPA. Finally, Part IV concludes with recommended solutions for restoring the law consistent with congressional intent in adopting CAPA—solutions that could easily be achieved through a simple amendment to the statute by Congress or similar regulations issued by Treasury.

II. WHY DID CONGRESS ADOPT THE CHURCH AUDIT PROCEDURES ACT?

Before understanding why Congress adopted the Church Audit Procedures Act, it is important to remember the broader context of the relationship between churches and the IRS as it relates to compliance with the United States Tax Code. The IRS is the agency tasked with the challenging responsibility of fairly and accurately administering the federal tax laws. As is true with individual and business taxpayers, the IRS must sometimes carry out its enforcement responsibilities with

an informal apology at a meeting of the American Bar Association Section on Taxation related to “inappropriate” and “insensitive” handling of tax-exempt applications by groups identified with the Tea Party and conservative causes. The apology came just before the release of a report by the Treasury Inspector General for Tax Administration finding that for several years the IRS had subjected tax-exempt applications by these organizations to heightened scrutiny and delayed processing. TREASURY INSPECTOR GENERAL FOR TAX ADMINISTRATION, INAPPROPRIATE CRITERIA WERE USED TO IDENTIFY TAX-EXEMPT APPLICATIONS FOR REVIEW, *supra* note 2; *ABA Transcript: Lois Lerner Says IRS Was Wrong in Its Handling of Tea Party Exemption Applications*, 72 EXEMPT ORGANIZATION TAX REVIEW NO. 1, 19 (July 2013). The TIGTA report and IRS announcement set off a political firestorm, which has resulted in several key IRS officials—including the IRS Commissioner—resigning from their posts or being placed on administrative leave. Additionally, a number of congressional hearings have been held, lawsuits have been filed by aggrieved parties, and new special protocols have been set in place as a remedy for organizations affected by the inappropriate review procedures.

11. While opinions differ at this juncture on the extent to which politics played a role in the IRS's handling of tax-exempt applications by Tea Party and other groups, as noted in a recent article published in *The Exempt Organization Tax Review*, the ultimate lesson for practitioners from the controversy is “more about the trouble caused by ambiguous laws that put too much power in low-level employees' hands.” Stokeld, *supra* note 2, at 595. The same could have been said about the inadequate laws and procedures in place for church tax inquiries and examinations before CAPA was adopted in 1984.

respect to tax-exempt organizations through inquiries and examinations to ensure compliance.¹² While not “taxpayers” in the traditional sense, churches and other tax-exempt charitable organizations may still be audited by the IRS for compliance in areas such as initial or ongoing eligibility for exempt status, public charity/private foundation classification, unrelated business income, excise taxes, requirements for filing returns and reports, and payment of employment taxes.¹³

A. *The Landscape Before CAPA*

The first federal tax code provision directly related to IRS income tax audits of churches was section 7605(c), adopted in 1969 when Congress began imposing taxes on the unrelated business income of churches.¹⁴ This subsection of the 7605 statute provided that the “books of account”¹⁵ of a church could not be examined to determine unrelated business income tax liability, unless the principal IRS officer for an internal revenue region (i.e., IRS Regional Commissioner at the time) or higher-ranking Treasury official believed that a church may be engaged in activities generating unrelated business income tax.¹⁶

The Regional Commissioner or higher-ranking Treasury official was also required to notify the church in advance of an examination of its financial records for this purpose.¹⁷ Finally, section 7605(c) limited IRS examinations of the religious activities of churches only to determining whether the organization qualified as a church for tax purposes and restricted examinations of financial records of churches strictly to matters

12. The term “audit” is often used interchangeably with “examination” to refer to an IRS review of an organization’s financial and other records to ensure compliance with the tax law. Besides sections 75 and 76 of Part 4 of the Internal Revenue Manual, there is little guidance or other resources available regarding IRS audits of tax-exempt organizations. One of the more exhaustive and authoritative resources in this area is authored by attorney and exempt organizations expert Bruce Hopkins. See BRUCE HOPKINS, *IRS AUDITS OF TAX-EXEMPT ORGANIZATIONS: POLICIES, PRACTICES, AND PROCEDURES* (2008).

13. *Id.* at 5.

14. See I.R.C. § 7605(c) (1970); see also Thomas A. Shaw, *Tax Audits of Churches*, 22 CATH. LAW. 247, 249 (1976). The Revenue Act of 1950 imposed the first unrelated business income tax on charitable organizations, but churches were not originally subject to these provisions. See IRM 7.27.4.1.2, 7.27.4.2.1 (Feb. 23, 1999) (recounting the legislative history of taxation of unrelated business income and churches).

15. The IRS had interpreted the statute’s reference to church “books of account” to include “accounting and bookkeeping records (including cash, books, ledgers, etc.) kept in the regular course of business to provide detailed financial records.” See *Hearing*, *supra* note 3, at 6, 65–66.

16. I.R.C. § 7605(c) (1970).

17. *Id.* Treasury Regulations required thirty days written notice in advance of the examination. Treas. Reg. § 301.7605-1(c) (1971).

of unrelated business income tax.¹⁸ Treasury Regulations and internal IRS procedures were adopted to implement these statutory restrictions.¹⁹

Yet, over time, lawmakers, practitioners, and religious leaders found the restrictions of section 7605(c) to be insufficient to dispel concerns over improper government intrusion into church records and activities.²⁰ The IRS has even conceded that the prior limitations imposed by section 7605(c) were “somewhat vague and relied on internal IRS procedures to protect the rights of a church in the examination process,” and that “there was some uncertainty regarding the scope of the investigations to which [section 7605(c)] applied and the nature of the records protected by the law.”²¹

B. Congress Passes CAPA in 1984

As noted above, before CAPA was adopted, the tax code provided only vague and limited guidance for the IRS to follow when conducting a church tax inquiry or examination. Congress responded by enacting CAPA as part of the Deficit Reduction Act of 1984 to establish more detailed statutory procedures and restrictions.²² These provisions are codified as section 7611 of the Internal Revenue Code.

First, to avoid “excessive entanglement” between churches and the federal government prohibited by the First Amendment,²³ CAPA limits pre-examination inquiries of churches by the IRS to only three situations: (1) to determine if the organization meets the tax-exemption requirements of a church under the Code, (2) to determine if the church has unrelated business income tax liability, or (3) to determine if the church is otherwise

18. I.R.C. § 7605(c) (1970). The original restrictions on church tax examinations under section 7605 are attributable to Utah Senator Wallace Bennett, who as a Mormon, was concerned with the unintended consequences of the unrelated business income legislation “which for the first time allow[ed] Internal Revenue Service to audit churches.” Senator Bennett commented that the draft language of the legislation was “too loose” and expressed fear that “the language would open it up so that the IRS could go through all the church books that pertain to religious activities.” Shaw, *supra* note 14, at 249.

19. See Treas. Reg. § 301.7605-1(c); *Hearing, supra* note 3, at 7.

20. See, e.g., *Hearing, supra* note 3, at 13–14 (statement of Rep. Mickey Edwards). These sorts of concerns had been raised years before CAPA was proposed. See, e.g., Shaw, *supra* note 14 (describing the challenges experienced by the National Council of Churches with an IRS audit resulting from the lack of clear guidance under then-existing section 7605(c)).

21. Amendments to the Regulations Regarding Questions and Answers Relating to Church Tax Inquiries and Examinations, 74 Fed. Reg. 39,003, 39,004 (proposed Aug. 5, 2009) (to be codified at 26 C.F.R. pt. 301); see also *Deficit Reduction Act of 1984: Church Audit Procedures*, in EXEMPT ORGANIZATIONS CONTINUING PROFESSIONAL EDUCATION, TECHNICAL INSTRUCTION PROGRAM FOR FY 1985, at 1 (1985).

22. See CAPA, *supra* note 1.

23. See *Lemon v. Kurtzman*, 403 U.S. 602 (1971); *Walz v. Tax Comm’n*, 397 U.S. 664 (1970).

engaged in taxable activities.²⁴ Additionally, certain heightened procedural requirements must be observed before the IRS can begin a church tax inquiry into one of these three areas. The most critical procedure—and the one involving the greatest challenges with CAPA in recent years²⁵—is that “an appropriate high-level Treasury official” must make a reasonable belief determination that a church tax inquiry is appropriate under the circumstances.²⁶ Other key provisions of the law include restrictions on examinations,²⁷ notice requirements,²⁸ and allowing an opportunity for churches to participate in pre-examination conferences with the IRS.²⁹

1. Political Leaders and Government Officials Speak Out on CAPA

Representative Mickey Edwards of Oklahoma and Senator Charles Grassley of Iowa were two of the key proponents of CAPA, which quickly garnered broad, bipartisan support.³⁰ Senator Grassley summarized the basic rationale for CAPA when introducing the legislation on the Senate floor: “[CAPA] should assist both the church under examination and the Internal Revenue Service in a tax audit and resolve clearly defined issues quickly in consonance with our Constitution.”³¹ He further explained:

[T]he enactment of the Church Audit Procedures Act is a significant step in clarifying the permissible audit procedures for churches. While the Internal Revenue Service audits a relatively small number of churches each year, the potential entanglement of church and state is an issue of great constitutional significance. . . .

This legislation is designed to give churches a special audit procedure to require the IRS to take greater care in the examination of churches than is required under current law. [CAPA] is drafted to be certain churches are protected from unfounded examinations without jeopardizing the efforts of the Service to stop the use of mail-order ministries to avoid tax.³²

24. I.R.C. § 7611(a)(2) (2012).

25. See discussion *infra* Part III.

26. I.R.C. § 7611(a)(2) (2012).

27. *Id.* § 7611(b).

28. *Id.* § 7611(a)(3), (b)(2)–(3).

29. *Id.* § 7611(b)(3)(A)(iii). Limits also exist under CAPA as to revocation of church tax-exempt status and time periods for inquiries and examinations and assessments. *Id.* § 7611(c), (d), (f).

30. Representative Mickey Edwards introduced the first version of the CAPA legislation in the Ninety-Seventh Congress. See *Hearings*, *supra* note 3, at 13.

31. 130 CONG. REC. 9152 (1984) (emphasis added).

32. *Id.*; see also *Hearing*, *supra* note 3, at 8–10 (providing an explanation of the draft CAPA

A congressional hearing on CAPA included testimony from Representative Edwards, who proposed the legislation in the House, as well as the Commissioner of the IRS and Deputy Assistant Secretary for Tax Policy in the Treasury. Representative Edwards described the growing support for CAPA as a fair way to approach the sensitive issues arising in the course of IRS audits of churches.³³ He emphasized that CAPA's purpose was not to hinder legitimate IRS efforts to uncover and prosecute tax fraud, especially given the rise at the time of so-called "mail-order ministries," groups that would use the cover of church status to operate illegal tax shelters.³⁴ To the contrary, in explaining the motivation for introducing CAPA, Representative Edwards stated, "[B]ecause Congress has up to now not clearly defined the guidelines for IRS audits and investigations, the constitutional protections are, in some cases, ignored. Not as a matter of IRS policy, but of practice."³⁵

Representatives from the IRS and Treasury indicated support for the

legislation at the time congressional hearings were held). An IRS continuing professional education text likewise described congressional intent behind the adoption of CAPA as follows: "Congress, when it enacted IRC 7611, tried to minimize the potential for church-state confrontations in Service examinations of churches by adopting detailed procedures to be followed whenever the Service was involved what the statute characterized as a 'church tax inquiry.' These procedures emphasized the need for a speedy determination of a church's tax liabilities without unnecessary examination of church records." Edward Gonzales et al., *Update on Churches Examinations Under IRC 7611, in EXEMPT ORGANIZATIONS CONTINUING PROFESSIONAL EDUCATION, TECHNICAL INSTRUCTION PROGRAM FOR FY 1992*, at 1 (1992); *see also Deficit Reduction Act of 1984: Church Audit Procedures, supra* note 21, at 1 ("Congress believed that these provisions will protect the rights of legitimate churches without unduly hindering IRS efforts to eliminate tax-avoidance schemes posing as religious organizations. Further the Congress believed that the adoption of detailed statutory rules will reduce misunderstandings between churches and the IRS and allow for a more stable and cooperative examination process."); *United States v. Living Word Christian Center*, No. 08-mc-37 (D. Minn. Nov. 18, 2008) (report and recommendation) (citing S. REP. NO. 98-169, at 873 (1984) ("Taking note of the inexperience of churches in dealing with the IRS and the misunderstandings that arose as a result, Congress enacted the CAPA to do away with vague limitations on church tax investigations and heavy reliance on internal IRS procedures to protect the rights of churches in the audit process.")).

33. *Hearing, supra* note 3, at 13–14 ("It is this basic concept of fairness that has allowed this act to garner the kind of broad ranging support that is evidenced by your witnesses today, and by the extraordinary array of grassroots organizations which have helped us already to gain 75 cosponsors in the House of Representatives.").

34. *Id.* at 16 ("Despite this rapidly expanding base of support for the act and its goals, you should be aware of the deep appreciation for the IRS efforts to uncover organizations which seek to evade taxes by fraudulently portraying themselves as churches.").

35. *Id.*; *see also id.* at 13 ("The Congress has, over the years, brought churches into the tax code and under the scrutiny of the Internal Revenue Service. Unfortunately, at the same time, the Congress has failed to spell out clearly enough its intended protection for the churches. This deficiency in current law is the reason the Church Audit Procedures Act is before the Congress today.").

general policy purposes achieved by CAPA.³⁶ IRS Commissioner Egger noted at the outset of his testimony, “We in the Internal Revenue Service are keenly aware of the sensitive nature of the church-state relationship and recognize the importance of the First Amendment’s constitutional mandate that government interference with the free exercise of religion be limited”³⁷ He went on to describe the minimum statutory requirements restricting church audits at the time as well as additional procedures implemented by the IRS to comply with the spirit of the law.³⁸ Treasury’s tax policy representative testified that the administration concurred with the stated purposes served by CAPA while offering recommendations for improving the bill, primarily related to the prevention of tax fraud.³⁹

2. Practitioners and Religious Leaders Speak Out on CAPA

Practitioners also testified, along with leaders from interested religious groups, such as the Evangelical Council for Financial Accountability, National Association of Evangelicals, National Council of Churches of Christ in the U.S.A., and Rutherford Institute. Together, these witnesses strongly encouraged Congress to adopt CAPA. Only one practitioner expressed serious concern with the legislation based on his opinion that, despite the First Amendment rights of religious organizations, churches should not be treated any differently for purposes of IRS inquiries or examinations.⁴⁰

Some of the hearing’s most striking testimony related to perceived abuses or, at the very least, poorly executed IRS audits of religious

36. The IRS Commissioner concluded that “[t]he objectives of [CAPA] are not dissimilar to our own” and expressed willingness to consider “suggestions about how we might improve our procedures to discourage church tax schemes and, at the same time, spare non-protesters from unreasonable inquiries.” *Id.* at 41 (statement of Hon. Roscoe L. Egger, Jr., Commissioner, Internal Revenue Service). The Deputy Assistant Secretary for Tax Policy stated that the administration shared Senator Grassley’s concerns regarding the “adequacy of safeguards on Internal Revenue Service church audit procedures, which were designed to protect the first amendment freedoms of religious organizations, and enforcement of the Federal tax laws applicable to all tax exempt organizations.” *Id.* (statement of Ronald A. Pearlman, Deputy Assistant Secretary for Tax Policy, Department of the Treasury).

37. *Id.* at 27 (statement of Hon. Roscoe L. Egger, Jr., Commissioner, Internal Revenue Service).

38. *Id.* at 33–38. Commissioner Egger explained, “The Regulations attempt to minimize Service contacts with churches to the barest extent necessary to ensure compliance with tax laws.” *Id.* at 34.

39. *Id.* at 41–46 (statement of Ronald A. Pearlman, Deputy Assistant Secretary for Tax Policy, Department of the Treasury).

40. *See id.* at 119 (statement of William J. Lehrfeld, Lehrfeld & Henzke).

organizations.⁴¹ The financial administrator of a large church recounted the story of an IRS audit spanning two and a half years, which cost his church hundreds of man-hours and more than \$100,000—ending in no tax assessments and the church’s exempt status being upheld.⁴² He alleged the IRS’s involvement with the church went beyond inquiry and audit into harassment. Not only was the church extensively examined without providing a reason for the review, but the IRS also initiated personal audits of the church’s CPA, legal counsel, and ministry staff.⁴³ The church administrator was convinced that the latitude of the procedures under existing law had caused abuses to occur; therefore, he called on Congress to enact CAPA as a step toward remedying these issues:

It is absolutely imperative that the problems that exist today in this arena not be left to unelected officials in the Federal agency. Congress should be resolute and clear in enunciating boundaries for these activities as they relate to churches. The IRS has proved over and over again that they cannot regulate themselves, and many of the IRS agents that have approached churches in these proceedings in recent years have shown an anti-church attitude by coming in with prejudiced opinions against the church and taking an attitude that the church is guilty until proven

41. Senator Grassley condemned this type of behavior by the IRS in his comments opening the hearing. *Id.* at 11–13 (statement of Sen. Charles E. Grassley, Chairman, Subcomm. on Oversight of the I.R.S. of the S. Comm. on Fin.). He also expressed that even when church audits result in exoneration, he was concerned with “how quickly the integrity, character, and moral foundations of small congregations could be undermined by innuendo, rumor, and press coverage during extended I.R.S. examinations.” *Id.* at 11.

42. *Id.* at 67–68 (statement of Michael Coleman, President, National Integrity Forum). The full account of the church’s experience with the IRS was included as part of Mr. Coleman’s written testimony. The church had established a history of openness and transparency with the IRS and therefore was more than willing to comply with the IRS audit. The church’s major frustration, however, was that the IRS would not inform the church of the reason for its inquiry. After repeated, unsuccessful attempts to learn the basis for the audit, the church finally sought a Freedom of Information request and uncovered that the IRS was in receipt of stolen internal church documents that had prompted the examination. *Id.* at 80–89.

43. *Id.* at 86–87 (“Our C.P.A. was later audited for the first time in over twenty years of practice [T]he preponderance of evidence indicates that at least three audits on individuals which were conducted were directly a result of the audit on the church. I was audited in 1979 after I had listed myself as the man to contact on the pre-examination questions. Our main attorney, Michael Ford, was audited shortly after he filed a power of attorney to represent the church before the I.R.S., and then in the Spring of 1981 another administrative staff member was audited. The result of all of these individual audits was that either there were refunds issued to the audited individual or a small amount of tax was paid (under \$100.00). So, it is obvious that none of the staff had been engaged in any illegal activity rendering these personal audits, in my opinion, strictly a form of harassment.”). Mr. Coleman further testified, “They were haughty and high-handed. They failed to answer our calls or respond to our correspondence. They misrepresented the facts to us on numerous occasions and were evasive. They were unresponsive to several Congressmen, Senators, and Administration officials who attempted to determine the real purpose of their procedures against our church. We continually found ourselves with no real recourse to solve the problems and had to continue to fight this ordeal through the slow and unresponsive bureaucratic system of the I.R.S.” *Id.* at 84.

innocent.⁴⁴

Reverend Dean Kelley, a noted church-state scholar, testified on behalf of the National Council of Churches of Christ in the USA (“NCCC”) and shared a similar account of an IRS audit of NCCC. According to Reverend Kelley, “Eventually, after the expenditure of many hundreds of man-hours of staff-work and thousands of dollars in legal fees, the NCCC on September 22, 1972, received a one-line, mimeographed letter from the IRS stating that the audit was completed and our tax status was unchanged.”⁴⁵ Another interesting similarity was that the IRS examination of NCCC was not limited to the organization but also extended into personal audits of ministry staff.⁴⁶

Reverend Kelley also offered compelling testimony regarding the need for heightened church audit procedures to avoid the appearance of the Service enforcing the tax law from political or religious prejudice.⁴⁷ Citing past instances of Democratic and Republican administrations improperly using the IRS as a political tool, Reverend Kelly expressed NCCC’s concern “to protect real churches from the recurrent efforts to use the tax code to punish behavior unpopular with the public or the incumbent administration.”⁴⁸ He testified of past congressional investigations showing that “the IRS maintained a list of ‘target organizations,’ including churches, for whom they wanted to make life difficult because those groups were viewed as ‘enemies’ of the then current administration.”⁴⁹ Reverend Kelley concluded, “The present legislation should help to insulate churches from political reprisals for preaching views that are unacceptable to those in political power.”⁵⁰

Finally, attorney Jeremiah Gutman testified regarding the difficult experiences of organizations outside the religious mainstream with the IRS, based on his three decades of law practice in civil liberties and civil rights.⁵¹ He echoed Reverend Kelley’s concerns with the potential for

44. *Id.* at 68.

45. *Id.* at 140 (statement of Rev. Dean M. Kelley, Director, Religious and Civil Liberty, National Council of Churches of Christ in the U.S.A.).

46. *Id.* at 147.

47. Reverend Kelly speculated that NCCC’s audit might have been motivated by politics rather than genuine concern over tax compliance: “Now the Tax Code provides a temptation to political administrations . . . to use the Tax Code as a weapon to punish critics of current administration policy And we surmise that may have been the reason for our audit.” *Id.* at 136.

48. *Id.* at 141.

49. *Id.*

50. *Id.*

51. *Id.* at 159 (statement of Jeremiah S. Gutman, Levy, Gutman, Goldberg, & Kaplan).

political abuse of the IRS⁵² and explained the benefits of adopting CAPA's statutory procedures and restrictions, especially from the perspective of religious minority groups: "[T]he experience of less affluent and less popular minority religions has demonstrated the need for unambiguous restraints and limitations against potential abuses, and assurances to religious organizations and personnel, as well as to Internal Revenue Service personnel, of what can be done, and when, and for how long, and under what circumstances."⁵³

In short, this legislative history reveals a collective effort by government officials and a cross-section of religious leaders from diverse faith traditions to cure the inadequate statutory procedures under then-existing law related to IRS audits of churches. What resulted from these discussions are the church audit procedures now found in section 7611 of the Internal Revenue Code—designed to protect the important interests of both churches and the IRS when inquiries or examinations are necessary to determine questions of church compliance with the tax code.

III. PRESENT CHALLENGES INVOLVING CAPA

Despite CAPA's effectiveness and widespread acceptance as a matter of federal tax policy since its adoption nearly three decades ago, one significant challenge has arisen in recent years that threatens the continuing validity of the law, namely the question over which government official should have the authority to initiate church tax inquiries under CAPA. This matter has been neglected by Congress and the Treasury Department since the congressionally mandated reorganization of the IRS in 1998 and was highlighted when a church successfully litigated the issue against the IRS in *United States v. Living Word Christian Center*.⁵⁴

52. *Id.* at 164–65 (“At least one President of the United States created his enemies’ list and abused his powers, among other ways, by unleashing agencies, including the Internal Revenue Service, against them . . .”). Mr. Gutman explained how CAPA could provide a level of protection to officials within the IRS who did not wish to use the power of the Agency for political purposes: “The Internal Revenue Service Commissioner and her or his subordinates who wish to act constitutionally should be able to point to a clear Congressional enactment which prohibits them from becoming entangled in the affairs of a church which may have found disfavor with a President, a member of Congress, or a group of vocal constituents. The Church Audit Procedures Act can provide such a shield against invitations to unconstitutional action.” *Id.* at 165–66.

53. *Id.* at 164.

54. *United States v. Living Word Christian Center*, No. 08-mc-37, slip op. at 7 (D. Minn. Jan. 30, 2009) (memorandum opinion and order) (concluding the Director of Exempt Organizations, Examination is not “an appropriate high-level Treasury official” within the meaning of Code section 7611). The District Court rejected an IRS appeal of the Magistrate Judge’s report and recommendation containing an in-depth analysis of the case. *Id.* In providing an overview of the

A. United States v. Living Word Christian Center

In April 2007, the IRS began an investigation of a Minnesota church, Living Word Christian Center (“Living Word”), due to concerns over alleged political involvement and excess benefit transactions between the church and its senior pastor.⁵⁵ The IRS’s letter to Living Word initiating a tax inquiry was signed by the official then serving as Director of Exempt Organizations, Examinations (“DEOE”).⁵⁶ The church’s response to the letter alleviated IRS concerns over political activity, but questions remained regarding potential private inurement with the church’s pastor, which resulted in the IRS opening a tax examination to investigate the church’s records.⁵⁷

Living Word later challenged the validity of the IRS’s initial notice of the tax inquiry based on advice from the church’s legal counsel that the notice was not authorized by “an appropriate high-level Treasury official” as required under section 7611(a).⁵⁸ The statute defines this term to mean “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.*”⁵⁹ Consistent with CAPA’s legislative history, Treasury Regulations had named the IRS Regional Commissioner (or higher-ranking Treasury official) to be the official responsible for initiating church tax inquiries.⁶⁰ The Regional Commissioner position was

Living Word litigation, this Article will cite to the Magistrate Judge’s report and recommendation, which included a detailed factual and procedural history of the case. *United States v. Living Word Christian Center*, No. 08-mc-37 (D. Minn. Nov. 18, 2008) (report and recommendation). The IRS had actually been made aware of these potential problems concerning CAPA long before *Living Word*, but the litigation was the first case to press the issue with the IRS in court. *See* Jonathan T. McCants, *The IRS Goes Back to the Drawing Board on Church Tax Inquiries*, 21 TAX’N OF EXEMPTS 43, 45 (Sept./Oct. 2009) (“Hence, it is clear that the IRS was well aware of the arguments against its practice in the church tax inquiry context, but nevertheless believed its practice was on solid legal footing. Despite almost a decade of using the DEOE as the reasonable belief determinant for church tax inquiries, it was not until the *Living Word* case that the Service’s reasoning was tested in court.”).

55. *Living Word*, slip op. at 2; *see also* Grant Williams, *Court Rules Against IRS in Church-Audit Case*, CHRON. OF PHILANTHROPY (Feb. 3, 2009), <http://philanthropy.com/article/Court-Rules-Against-IRS-in/63006/>.

56. *Living Word*, slip op. at 2.

57. *Id.* at 2–3.

58. *Id.* at 3–4.

59. I.R.C. § 7611(h)(7) (2012) (emphasis added).

60. As noted in the court’s discussion, Treasury Regulations had interpreted the “appropriate high-level Treasury official” to be a Regional Commissioner or higher-ranking Treasury official consistent with CAPA’s legislative history. *Living Word*, slip op. at 11 (“The IRS’s identification of the Regional Commissioner as the appropriate official to make the required reasonable-belief determinations is not surprising given that the House Conference Report for the CAPA made the same selection.” (citing H.R. REP. NO. 98-861, at 1101 (1984) (Conf. Rep.)); *see also* 130 CONG. REC. S4485-86 (daily ed. April 12, 1984) (statement of Sen. Grassley, Chairman, Subcomm. on Oversight

eliminated, however, during a congressionally mandated restructuring of the IRS in 1998,⁶¹ and Congress failed to then redefine who would be an appropriate high-ranking Treasury official under section 7611(a).⁶²

The Treasury Department likewise did not engage in any official rulemaking process to update its interpretation of the statute following the reorganization.⁶³ Instead, as evidenced in the Internal Revenue Manual, the IRS informally reinterpreted the statute to allow the DEOE to be the official responsible for making the reasonable belief determination to initiate church tax inquiries.⁶⁴

Living Word challenged this interpretation as inconsistent with the 7611 statute and congressional intent in adopting CAPA. The church refused to provide documents demanded by the IRS in examining the tax-exempt status of the church, which led to the IRS bringing a petition in court to enforce a summons related to the church's records.⁶⁵ Living Word argued that the DEOE should not qualify as an appropriate high-level Treasury official for purposes of section 7611 because, unlike the Regional Commissioner, "the DEOE does not have responsibilities over the many different IRS functions and types of taxpayers"⁶⁶ The church argued the Regional Commissioner's broad perspective—lacking in the DEOE—was "essential to an understanding of the church-state concerns underlying section 7611."⁶⁷ The IRS, on the other hand, tried justifying its interpretation based on Congress' goal of restructuring the agency away from a rank and geography system to more of a specialization structure based on taxpayer types.⁶⁸

of the I.R.S. of the S. Comm. on Fin.).

61. IRS Restructuring and Reform Act of 1998, Pub. L. No. 105-206, § 1001(a), 112 Stat. 685.

62. *Living Word*, slip op. at 11–13. While Congress did revise certain aspects of the 7611 statute to reflect the reorganization, it failed to address the issue of who would be the appropriate high-level Treasury official to initiate church tax inquiries and audits. For example, a reference in section 7611(f)(1) to the "Assistant Commissioner for Employee Plans and Exempt Organizations of the Internal Revenue Service" was replaced with "Secretary." See IRS Restructuring and Reform Act of 1998, Pub. L. No. 105-206, § 1102, 112 Stat. 685, 705.

63. This failure to act by the Treasury/IRS was concerning to the court: "And, the IRS's deliberate choice to avoid subjecting this interpretation to formal rulemaking causes this Court some concern. This concern is heightened given the opportunity the IRS has had to formalize the interpretation since the almost decade-old elimination of the position of Regional Commissioner. The public deliberation that would occur as a result of formal rulemaking would be an important part of identifying the types of First Amendment concerns that motivated the enactment of the CAPA in the first place." *Living Word*, slip op. at 22.

64. *Id.* at 13–14.

65. *Id.* 1, 4–6.

66. *Id.* at 23–24.

67. *Id.*

68. *Id.* at 24.

The Minnesota District Court rejected the IRS's interpretation and found in favor of Living Word.⁶⁹ The court began its analysis by recognizing that “the Constitution protects religion from undue government intrusion,” and “Congress, when it enacted the CAPA, was aware of the potential problems—including the government's possible [intrusion] into church affairs and into the special relationship between a church and its members—that arise when the IRS examines a church's records.”⁷⁰ Given these church-state concerns, the court reasoned, “Congress clearly wanted the decision to investigate a church to be approved by a high-level Executive Branch official.”⁷¹ The Regional Commissioner had met this standard because “[t]he broad responsibilities and experience of an official with such a high-profile position would make it likely that she has a heightened political and policy sensitivity for balancing the need for vigorous enforcement of our tax laws and the avoidance of excessive government intrusion into a church's exercise of religious freedom.”⁷²

After carefully comparing the responsibilities previously held by a Regional Commissioner against those of the DEOE, the court found that the IRS's informal designation of the DEOE did not satisfy congressional intent for the high-level official required by CAPA.⁷³ Instead, in the court's opinion, the logical equivalent of the Regional Commissioner after the IRS reorganization would be the Commissioner of Tax Exempt and Government Entities—two levels of authority above that of the DEOE that had initiated the tax inquiry of Living Word.⁷⁴ Moreover, the court reasoned,

Although the duties of the DEOE are national in scope, she is still an examiner, indeed the chief examiner, of tax exempt organizations including churches. *It is at odds with the legislative purpose of vesting the authority to halt over-zealous examination of churches in a high-level Treasury official to then delegate this watchdog responsibility down to the director of church examinations.*⁷⁵

Under this analysis, the court concluded that an appropriate high-level Treasury official had not made the necessary reasonable belief determination required by section 7611(a) to initiate a tax inquiry of

69. *Id.* at 24–31; *see also* Williams, *supra* note 55.

70. *Living Word*, slip op. at 25.

71. *Id.*

72. *Id.*

73. *Id.* at 25–30.

74. *Id.* at 27–28.

75. *Id.* at 28 (emphasis added).

Living Word.⁷⁶

B. Proposed Regulations After Living Word

1. Treasury Proposes the Director of Exempt Organizations as the Appropriate High-Level Treasury Official Under CAPA

Despite its disagreement with the conclusion reached in *Living Word*, the IRS chose not to disturb the district court's decision with an appeal. Instead, the Treasury Department responded several months later by proposing new amended regulations to the statute.⁷⁷ Treasury stated the following intent in announcing the proposed rules: "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."⁷⁸

The proposed regulations named the IRS Director of Exempt Organizations as the appropriate high-level Treasury official for purposes of the reasonable belief and inquiry notice requirements under CAPA.⁷⁹ However, the Director of Exempt Organizations was only one rank higher than the Director of Exempt Organizations, Examination ("DEOE") that had initiated church tax inquiries following the 1998 restructuring of the IRS until the court challenge brought in *Living Word*. There was no justification offered in the proposed regulations for naming the Director of Exempt Organizations for this purpose, other than a brief, general job description that indicated the director's level of responsibility within the Service: "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."⁸⁰

2. Comments Suggest Treasury's Proposal Is Problematic

A number of comments were submitted by interested parties in

76. *Id.* at 30–31.

77. Amendments to the Regulations Regarding Questions and Answers Relating to Church Tax Inquiries and Examinations, 74 Fed. Reg. 39,003 (proposed Aug. 5, 2009) (to be codified at 26 C.F.R. pt. 301).

78. *Id.* at 39,003.

79. *Id.* at 39,005.

80. *Id.*

response to this notice of proposed rulemaking, and a public hearing was held regarding the matter on January 20, 2010.⁸¹ Not one comment expressly supported the Treasury's proposed interpretation that the Director of Exempt Organizations should be the appropriate high-level Treasury official to initiate church tax inquiries and examinations under CAPA. The only noteworthy feedback favoring the Treasury's actions came from the Americans United for Separation of Church and State, yet even its comments stopped short of specifically endorsing the Treasury's pick.⁸²

Instead, the clear majority of comments submitted expressed concern over giving the Director of Exempt Organizations this responsibility. The consistent message throughout these comments was that appointing the Director of Exempt Organizations as the official responsible for initiating church inquiries was inconsistent with section 7611 and congressional intent underlying the law.⁸³

Attorney Marcus Owens with the D.C. law firm Caplin & Drysdale was in a unique position to provide feedback on the proposed regulations. After serving for twenty-five years in the IRS tax-exempt division, the last ten of which as Director of Exempt Organizations, Mr. Owens' testimony offered a historical perspective of section 7611 and compelling logic for why the Service's proposed regulations were inconsistent with the congressional intent behind CAPA.⁸⁴ He explained, "By any normal

81. Amendments to the Regulations Regarding Questions and Answers Relating to Church Tax Inquiries and Examinations; Hearing, 74 Fed. Reg. 59,943 (notice of public hearing on proposed rulemaking Nov. 19, 2009) (to be codified at 26 C.F.R. pt. 301); Fred Stokeld, *EO Director Shouldn't Approve Church Audits, Witnesses Say*, 126 TAX NOTES 445 (Jan. 25, 2010) ("Witnesses at an IRS hearing in Washington were unanimous in opposing a proposal that would have the director of the agency's exempt organizations function sign off on church tax inquiries.").

82. See Letter from Americans United for Separation of Church and State to the IRS RE: Proposed Amendments to the Regulations Regarding Questions and Answers Relating to Church Tax Inquiries and Examinations (Nov. 2, 2009) (on file with the author). The comments submitted by Americans United were generally supportive of providing a fix to the proposed regulations so that audits of politically active churches could resume following the *Living Word* case. *Id.* at 1.

83. Stokeld, *supra* note 81; Memorandum from the American Center for Law & Justice to the IRS RE: Proposed Amendments to the Regulations Regarding Questions and Answers Relating to Church Tax Inquiries and Examinations (Nov. 3, 2009) (on file with the author); Letter from Alliance Defense Fund to the IRS RE: Proposed Amendments to the Regulations Relating to Church Tax Inquiries and Examinations (Nov. 2, 2009) (on file with the author); Letter from Marcus Owens of Caplin & Drysdale to the IRS RE: Proposed Amendments to the Regulations Relating to Church Tax Inquiries and Examinations (Oct. 13, 2009) (on file with the author).

84. See Marcus Owens letter, *supra* note 83; Letter from Marcus Owens of Caplin & Drysdale to the IRS RE: Written Request to be Heard and Outline of Testimony on Proposed Regulations Relating to Church Tax Inquiries and Examinations (Dec. 8, 2009) (on file with the author). Even before the *Living Word* case and the Treasury Department issuing proposed regulations, Mr. Owens had been outspoken with his concern that a more senior Treasury official be named to initiate church

definition, the EO Director's 'rank' is significantly lower than the former Regional Commissioner's."⁸⁵ Additionally, Mr. Owens identified two important characteristics that the official responsible for approving church tax inquiries at the IRS should possess to be consistent with congressional intent: (1) experience making high-level sensitive policy judgments, and (2) lack of direct involvement in church tax enforcement.⁸⁶ With these considerations in mind, Mr. Owens proposed the Deputy Commissioner, Services and Enforcement be named for this purpose because the position "shares the former Regional Commissioners' overall responsibility for taxation of all types of taxpayers"; "has required ranks"; and "preserves independent review."⁸⁷

While the Alliance Defending Freedom (formerly the Alliance Defense Fund) shared Marcus Owens' view that the responsibility for initiating church tax inquiries should lie with the Deputy Commissioner, Services & Enforcement,⁸⁸ the American Center for Law and Justice ("ACLJ") took an even more conservative approach by suggesting that this responsibility should rest at least with the IRS Commissioner, if not the Treasury Secretary.⁸⁹ ACLJ argued that the *Living Word* court's analogy of the former Regional Commissioner to the new Commissioner of Tax Exempt and Government Entities could be problematic because the two positions were not entirely equivalent.⁹⁰ From a practical standpoint, ACLJ also suggested that designating the IRS Commissioner or Treasury Secretary for this purpose could be beneficial in the event that one day the IRS could be restructured again, eliminating offices below the Treasury Secretary and IRS Commissioner which are not statutorily mandated.⁹¹

In all, these comments suggested that the Treasury's interpretation of the section 7611 statute in the proposed regulations was yet again problematic. Although Treasury proposed elevating the responsibility for initiating church tax inquiries one level of authority beyond that which was challenged in the *Living Word* case, no comments expressly offered

tax inquiries and examinations consistent with the section 7611 statute and congressional intent. See McCants, *supra* note 54, at 45.

85. Marcus Owens letter, *supra* note 83, at 2.

86. *Id.* at 3.

87. *Id.* at 8.

88. Alliance Defense Fund letter, *supra* note 83, at 3. ADF was concerned the Treasury's proposal "would threaten church/state neutrality, would further undermine the public's confidence in IRS neutrality and fair play, and would cause continued litigation and confusion on what constitutes a valid church tax inquiry." *Id.* at 2.

89. American Center for Law & Justice letter, *supra* note 83, at 7.

90. *Id.* at 6.

91. *Id.*

support for this proposal. Instead, experts in exempt organizations law and religious liberty advocates all agreed that, to be consistent with the section 7611 statute and Congress' intent in passing the law, a more senior IRS official than the Director of Exempt Organizations should be responsible for approving church tax inquiries. Presumably, the Treasury Department recognizes the validity of these concerns because it has since failed to finalize the regulations since proposing them in 2009,⁹² despite the fact that Treasury has included final regulations under section 7611 in the last four years of its official priority guidance plan.⁹³

IV. WHAT MUST BE DONE NOW TO RESTORE CAPA FOR CHURCHES AND THE IRS?

By all indications, the IRS has ceased auditing churches for federal income tax compliance until there is some resolution to the question of who qualifies as an appropriate high-level Treasury official to initiate church tax inquiries and examinations under CAPA.⁹⁴ For this issue to remain unresolved for fifteen years after the IRS reorganization in 1998 and five years after the *Living Word* case was decided in 2009 makes a mockery of the federal government's tax administration.⁹⁵ The seeming lack of enforcement by the IRS also invites the increased possibility of non-compliance and abuse of the tax laws related to churches. Rectifying this issue is necessary because the longer that CAPA is seemingly

92. Attorney Bruce Hopkins is one exempt organizations expert to publicly express his opinion that the Treasury's failure to finalize its proposed regulations is due to fear that naming the Director, Exempt Organizations as the high-level Treasury official to initiate church tax inquiries and audits will result in future litigation and lengthy delays. Paul Streckfus, *My Annual Bruce Hopkins' Review*, EO TAX JOURNAL 2013-53 (Mar. 27, 2013), <http://eotaxjournal.com/eotj/?p=2398>.

93. See DEPARTMENT OF THE TREASURY, 2013-2014 PRIORITY GUIDANCE PLAN 11 (Aug. 9, 2013); DEPARTMENT OF THE TREASURY, 2012-2013 PRIORITY GUIDANCE PLAN 11 (Nov. 19, 2012); DEPARTMENT OF THE TREASURY, 2011-2012 PRIORITY GUIDANCE PLAN 10 (Sept. 2, 2011); DEPARTMENT OF THE TREASURY, 2010-2011 PRIORITY GUIDANCE PLAN 10 (Dec. 7, 2010).

94. See *supra* note 9 and accompanying text.

95. As exempt organizations journalist and commentator Paul Streckfus put it, "The best example of total dereliction of duty is the failure to finalize the section 7611 regulations, which would take all of five minutes . . . For reasons unfathomable to anyone but an IRS bureaucrat, the IRS has been sitting on its collective derriere for almost four years now." Paul Streckfus, *Latest Example of IRS Dysfunctionality*, EO TAX JOURNAL 2013-41 (Mar. 5, 2013), <http://eotaxjournal.com/eotj/?p=2359>. Another outspoken critic of the IRS in this area, Rev. Barry Lynn of Americans United for Separation of Church and State, lamented that "two monkeys with a typewriter" could have addressed the issues with the 7611 statute in a matter of minutes. Bob Smietana, *IRS Shouldn't Ban Clergy Endorsements, Panel Says*, USA TODAY (Aug. 14, 2013), <http://www.usatoday.com/story/news/nation/2013/08/14/irs-shouldnt-ban-clergy-endorsements-panel-says/2657817/>.

inoperative, the more controversy will continue to compound.⁹⁶ And if this state of affairs continues to worsen, it is even possible that legislators could consider eliminating CAPA altogether⁹⁷—a course of action that would certainly not be in the best interest of churches or the IRS.

A. Congress Should Amend Section 7611 Following Treasury's Failure to Act.

Section 7611, the codification of CAPA, currently defines an “appropriate high-level Treasury official” for purposes of the statute 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.”⁹⁸ This is problematic, of course, because internal

96. One of the more high-profile controversies resulting from the IRS's failure to audit churches has arisen in the context of the political campaign prohibition. Since 2008, hundreds of churches have been engaging in political campaign activity directly prohibited by section 501(c)(3) as part of the Alliance Defending Freedom's “Pulpit Freedom Sunday,” and the IRS's failure to audit these churches has spurred a lawsuit by the Freedom From Religion Foundation. *See* Freedom From Religion Foundation, Inc. v. Comm'r, 12-CV-818 (W.D. Wis. Nov. 14, 2012). The Alliance Defending Freedom and the Freedom From Religion Foundation disagree about the constitutionality of 501(c)(3)'s ban on political campaign activity by churches, but both agree that the IRS should enforce the law, which includes auditing churches for non-compliance with the tax code. Another example of concerns over the lack of church tax audits was evidenced in a 2011 staff report to Senator Charles Grassley regarding six media-based ministries organized as churches. The Commission on Accountability and Policy for Religious Organizations, convened by ECFA (Evangelical Council for Financial Accountability) at the request of Senator Grassley to address the tax policy issues raised by his staff, included as one of its recommendations the need for the IRS and Treasury Department to rectify the issue of who is an appropriate high-level Treasury official under section 7611 for effective administration of the law. *See* COMMISSION ON ACCOUNTABILITY AND POLICY FOR RELIGIOUS ORGANIZATIONS, ENHANCING ACCOUNTABILITY FOR THE RELIGIOUS AND BROADER NONPROFIT SECTOR 31 (2012).

97. This concern is more than speculative. In response to Congress' request for public input on comprehensive tax reform in 2013, a secular advocacy group suggested that CAPA should be eliminated from the tax code, along with a few other provisions related to churches. *See* Letter from Secular Coalition for America to the Honorable David Reichert, Chairman, Charitable/Exempt Organizations Working Group, & the Honorable John Lewis, Vice Chairman, Charitable/Exempt Organizations Working Group, RE: Comments: Charitable/Exempt Organizations Tax Reform Working Group of the House Ways and Means Committee (Apr. 15, 2013) (on file with the author); JOINT COMMITTEE ON TAXATION, REPORT TO THE HOUSE COMMITTEE ON WAYS AND MEANS ON PRESENT LAW AND SUGGESTIONS FOR REFORM SUBMITTED TO THE TAX REFORM WORKING GROUPS 496 (2013). The group raised an unprecedented challenge to CAPA, arguing that the heightened church inquiry and examination procedures are “[o]ne of the most significant benefits churches receive” because they result in “practical immunity from IRS auditing.” Secular Coalition, *supra* at 1. While these recommendations are misguided, they could possibly tempt lawmakers to “throw the baby out with the bathwater” by eliminating the church audit procedures of section 7611 altogether rather than taking the simple steps necessary to improve the law and ensure its continuing validity for the sake of churches and the IRS.

98. I.R.C. § 7611(h)(7) (2012).

revenue regions no longer exist in the current IRS organizational structure following the 1998 reorganization of the agency, as highlighted in the *Living Word* litigation.

In theory, IRS inquiries and examinations could still continue today consistent with section 7611 if all were approved directly by the Secretary of the Treasury. In practice, however, this responsibility has always been delegated below to high-ranking IRS officers administering the tax law (such as the IRS Regional Commissioner before the reorganization).

This technicality paralyzing CAPA could be resolved in one of two obvious ways: (1) finalizing Treasury Regulations to reinterpret section 7611, or (2) directly amending the statutory definition of an appropriate high-level Treasury official in section 7611(h)(7).⁹⁹ Under either alternative, it would be necessary to carefully consider how best to preserve congressional intent when CAPA was introduced in 1984 within the IRS's current organizational structure.

While both are viable options for resolving this issue, it seems that given the surrounding circumstances the better and more efficient course of action would be for Congress to step in and directly amend section 7611's definition of an appropriate high-level Treasury official, rather than continue to leave the issue idling in the hands of the Treasury Department. Although Treasury began the process of adopting updated regulations in 2009 following the *Living Word* case, it has failed to take any further action after receiving substantial concerns from constituents over its proposal to name the IRS Director of Exempt Organizations as the appropriate high-level Treasury official under section 7611. After nearly five years without any express support for Treasury's proposal and no evident progress being made—as indicated by Treasury's priority guidance plans issued since 2010—it is unclear when, if ever, Treasury intends to act on this issue.¹⁰⁰

On the other hand, Congress could easily rectify this issue by simply

99. While this Article has focused on rectifying who is an appropriate high-level Treasury official under CAPA given the significant controversy over this issue in recent years, a similar change should be made in section 7611 to update references to the Regional Counsel position also eliminated by the IRS reorganization in 1998.

100. When asked to comment about the matter publicly, Treasury representatives have indicated that work on the final regulations is ongoing. See Paul Streckfus, *Ruth Madrigal's Regs Update*, EO TAX JOURNAL 2013-62 (Apr. 11, 2013), <http://eotaxjournal.com/eotj/?p=2424>. After years since the regulations were proposed and with numerous other projects to occupy the Treasury's time, including regulations under the health care reform law, one has to wonder where final regulations under section 7611 rank in the Treasury's list of priorities. Some have speculated it "qualifies on all counts as dead last in the hearts and minds of the IRS." Paul Streckfus, *Simultaneous Release of 2013-2014 Priority Guidance Plan and Fourth Quarter Update to the 2012-2013 Priority Guidance Plan*, EO TAX JOURNAL 2013-145 (Aug. 13, 2013), <http://eotaxjournal.com/eotj/?p=2670>.

amending the statute and replacing references to the “principal Internal Revenue officer for an internal revenue region” in section 7611(h)(7)’s definition of appropriate high-level Treasury official with another high-ranking Treasury official consistent with the IRS’s current organizational structure and congressional intent. This would eliminate altogether the need for Treasury to trudge through finalizing its problematic regulations and fast track the issue to a proper resolution. After all, Congress was the one that created the problem by failing to update the statute when mandating the IRS’s restructuring in 1998.¹⁰¹ Congress should now follow up by taking responsibility for resolving this issue of constitutional significance.¹⁰² Churches, the IRS, and the public deserve better.

B. The Deputy Commissioner, Services and Enforcement Should Be Named the Appropriate High-Level Treasury Official Under CAPA.

Given the 1998 restructuring of the IRS away from a regional system to one organized by taxpayer type, there is no exactly analogous position in the IRS today to the former Regional Commissioner. It is possible, however, to consider what aspects of the Regional Commissioner’s position led Congress to entrust this official with the responsibility for initiating church tax inquiries and examinations. As noted by attorney Marcus Owens in his comments on the 2009 proposed Treasury Regulations, the Regional Commissioner was a very high-ranking Treasury official, reporting directly to the Commissioner of the IRS who in turn reported to the Treasury Secretary.¹⁰³ Each Regional Commissioner, responsible for one of four internal revenue regions of the United States, was required to make sensitive policy judgments from their experience overseeing a broad range of taxpayers. Moreover, Regional Commissioners were not directly involved in church tax law enforcement, thereby creating an additional layer of accountability from a disinterested official who had little or no day-to-day responsibilities in exempt

101. See *supra* note 62 and accompanying text.

102. It seems especially appropriate now for Congress to act given the concerted effort by members of both political parties to accomplish what has been referred to as “comprehensive tax reform.” While it remains uncertain whether all the hurdles necessary to accomplish tax reform can or will be cleared, high-ranking members of Congress from both parties have been working together in earnest toward the first major overhaul to the Code since 1986. The House Ways and Means Committee and Senate Finance Committee have held numerous hearings, solicited public input, formed working groups, issued options papers, and even released the “Tax Reform Act of 2014,” draft legislation spanning nearly 1,000 pages. More detailed information about these efforts can be found at www.TaxReform.gov.

103. Marcus Owens letter, *supra* note 83, at 2; see also INTERNAL REVENUE SERVICE, INTERNAL REVENUE SERVICE DATA BOOK 40-41 (IRS Communications Division, 1997).

organization oversight.¹⁰⁴

Within the current IRS organizational structure, several options have been proposed for who could qualify as the appropriate high-level Treasury official under section 7611: (1) IRS Commissioner; (2) IRS Deputy Commissioner, Services and Enforcement; (3) Commissioner, Tax-Exempt and Government Entities; (4) Director of Exempt Organizations; and (5) Director of Exempt Organizations, Examination.¹⁰⁵

Starting with the lowest-ranking official, the Director of Exempt Organizations, Examination (“DEOE”) was first considered by the IRS to qualify as an appropriate high-level Treasury official following the 1998 reorganization. Treasury did not engage in any formal rulemaking process in making this determination, but instead the IRS internally delegated the responsibility of approving church inquiries to the DEOE after the Regional Commissioner position was eliminated.¹⁰⁶ For the reasons articulated by the court in the *Living Word* case, this interpretation is clearly inconsistent with congressional intent in adopting CAPA.¹⁰⁷ Furthermore, Treasury’s decision to abandon this interpretation in its 2009 proposed regulations indicates that even the federal government no longer considers the DEOE to be a viable alternative to the Regional Commissioner in approving church tax inquiries.

When Treasury issued amended regulations in 2009 following the IRS’s defeat in *Living Word*, it proposed—without any rationale for doing so—the IRS Director of Exempt Organizations.¹⁰⁸ It does not bode well for Treasury that none of the comments received in response to its proposed regulation supported this interpretation.¹⁰⁹ The comments observed that, although one rank higher than the DEOE, the Director of Exempt Organizations is still lower in rank when compared to the IRS Regional Commissioner who had reported directly to the IRS Commissioner. More importantly, the Director of Exempt Organizations is directly involved in oversight of tax compliance by churches and does not possess the same broad experience in working with different types of taxpayers and making sensitive policy judgments like the Regional

104. Marcus Owens letter, *supra* note 83, at 5.

105. These options are listed in order of rank and exclude the most high-ranking official, the Secretary of the Treasury, because section 7611 directly contemplates the Treasury Secretary being an appropriate government official to initiate church tax inquiries. I.R.C. § 7611(a) (2012).

106. See *supra* note 64 and accompanying text.

107. See discussion *supra* Part III.A.

108. See Amendments to the Regulations Regarding Questions and Answers Relating to Church Tax Inquiries and Examinations, 74 Fed. Reg. 39,003, 39,004 (proposed Aug. 5, 2009) (to be codified at 26 C.F.R. pt. 301).

109. See discussion *supra* Part III.B.

Commissioner did. To name the Director of Exempt Organizations as the appropriate high-level Treasury Official under section 7611(a) would clearly contravene the consensus of experts in exempt organizations and religious liberty advocates.

Moving up the chain of command, the court in *Living Word* suggested the logical equivalent of the Regional Commissioner for purposes of section 7611 would be the Commissioner of Tax Exempt and Government Entities.¹¹⁰ The court observed that the IRS was divided into four geographical revenue regions before reorganizing into four taxpayer-type divisions. In the court's opinion, since the TE/GE Commissioner became the official responsible for supervising one of the four taxpayer divisions (akin to one of the four internal revenue regions) and the one including churches as tax-exempt organizations, the TE/GE Commissioner could assume the responsibilities previously held by the Regional Commissioner in the area of church tax audits. While this is certainly a more plausible alternative than the Treasury's previous proposals of DEOE and DEO, this was not viewed as the ideal solution by any of those providing feedback to the Treasury on its proposed regulations in 2009.¹¹¹

Other than the TE/GE Commissioner, the only other remaining possibilities for an appropriate high-level Treasury official would be the IRS Commissioner or the IRS Deputy Commissioner, Services and Enforcement. As discussed in Part III of this Article, the ACLJ took the most conservative approach when commenting on the proposed section 7611 regulations by suggesting that only the IRS Commissioner or Treasury Secretary should initiate church tax inquiries.¹¹² One of the practical benefits of delegating this responsibility to such a high-level official is that it avoids having to rename another official in the statute or regulations if the IRS were to restructure again in the future. A potential objection, though, to this proposal might be that even before the IRS restructuring in 1998, the Treasury Secretary delegated this responsibility one level below the IRS Commissioner to a Regional Commissioner. It may also be unpalatable to name the Treasury Secretary and IRS Commissioner as the only officials able to initiate church tax inquiries given their existing responsibilities in so many other areas of tax policy and administration.

110. See discussion *supra* Part III.A.

111. See discussion *supra* Part III.B.

112. Other tax commentators have since suggested this approach as well. See Paul Streckfus, *My Annual Bruce Hopkins' Review*, EO TAX JOURNAL 2013-53 (Mar. 27, 2013), <http://eotaxjournal.com/eotj/?p=2398>.

On balance, it seems the Deputy Commissioner, Services and Enforcement would be the most viable alternative to assume the responsibilities previously held by the Regional Commissioner under CAPA. As noted in several of the comments to Treasury in response to the proposed regulations, naming the Deputy Commissioner for this purpose would be consistent with congressional intent because, like the Regional Commissioner before the reorganization, the Deputy Commissioner is only one rank below the IRS Commissioner. The Deputy Commissioner is also not intimately involved in oversight of church tax compliance and can offer a broader level of experience across taxpayer types when making sensitive judgments such as when to approve a government inquiry or examination into the records and activities of churches.

In the present controversy over the IRS's inappropriate handling of tax-exempt applications based on perceived political affiliation, one of the major concerns highlighted in the Treasury Inspector General's report was that the alleged targeting of Tea Party and other conservative groups was said to begin with "low-level" IRS employees in a field office in Cincinnati. While the exact nature of the circumstances surrounding the controversy are still unfolding, a point of agreement exists across political lines that employees with lower levels of authority in the IRS should not be independently making policy judgments in sensitive areas of tax compliance, especially those evoking constitutional concerns.¹¹³ The lawmakers who proposed CAPA had the foresight to prevent similar criticisms in the church context by requiring the Secretary of the Treasury or other appropriate high-level Treasury official to make the determination of when it is appropriate to audit the records and activities of churches. Amending section 7611 to name the Deputy Commissioner, Services and Enforcement as the appropriate high-level Treasury official (or adopting Treasury regulations to that effect) would help to ensure that similar problems do not arise today in the context of IRS audits of religious houses of worship.

V. CONCLUSION

So, why the Church Audit Procedures Act? The broad, bipartisan coalition of lawmakers who advanced CAPA in 1984 recognized the need to have unambiguous and heightened statutory procedures in place to protect churches and the IRS when an inquiry or examination was

113. *See supra* note 11.

necessary to determine a church's compliance with the tax code. While respecting the free exercise of religion and guarding against excessive entanglement between church and state consistent with the First Amendment, the specific statutory procedures for church income tax audits would also help to reduce possible misunderstandings and reinforce trust between churches and the IRS as well as the public. Congress also believed that CAPA would strike an appropriate balance by still allowing the government the enforcement authority it needs when necessary with respect to legitimate churches and to prevent abuse of the tax laws. Put simply, CAPA helps to safeguard precious First Amendment freedoms and to insulate the IRS from criticisms of abuse or insensitivity when undertaking inquiries or examinations into church activities and records.

Fast-forward thirty years, and the need for CAPA is only greater. Churches have become less a part of mainstream American culture today than they were three decades ago,¹¹⁴ and the possibility for improper government overreach into churches increases as religious institutions become more of a minority. Moreover, the IRS has also recently come under major scrutiny for its admittedly inappropriate and insensitive handling of tax-exempt applications based on perceived political affiliation. While the details of the controversy are still unfolding, one thing is for certain. The level of trust in the IRS exempt organizations division appears to be at an all-time low. In proposing CAPA before Congress, Senator Charles Grassley stated, "We must closely study our current procedures to be certain they adequately protect churches in the future when we may be unable to guarantee a responsible administration of the agency."¹¹⁵ These comments ring especially true in today's environment where a responsible administration of the IRS is no doubt in question.

Given the historical motivations for CAPA—underscored by present realities—something must be done now to restore the law. Given the Treasury Department's flawed proposed regulations and its failure to make necessary changes since, Congress should take responsibility for resolving the lingering issue brought to light in the *Living Word* case of who is an appropriate high-level Treasury official under CAPA to initiate church tax inquiries and examinations following the IRS reorganization in 1998. Congress should leverage current interest in tax reform as a window of opportunity to amend section 7611's definition of an

114. "Nones" on the Rise, PEW RESEARCH CENTER, <http://www.pewforum.org/2012/10/09/nones-on-the-rise/> (Oct. 9, 2012).

115. *Hearing*, *supra* note 3, at 2–3.

appropriate high-level Treasury official consistent with congressional intent so that proper inquiries and examinations can resume under CAPA. A simple amendment to the section 7611 statute naming the Deputy Commissioner, Services and Enforcement¹¹⁶ as the appropriate high-level Treasury official to initiate church tax inquiries and examinations would resolve the present challenges involving CAPA and allow for effective administration of the law into the future—a resolution everyone could celebrate as CAPA marks its thirty-year anniversary in the tax code.

116. Hearings on the 2009 proposed Treasury regulations to section 7611 indicate that the Deputy Commissioner, Services and Enforcement would satisfy congressional intent and be the most satisfactory alternative to the Regional Commissioner position that was eliminated by the reorganization of the IRS in 1998. *See* discussion *supra* Part IV.