INTERNAL REVENUE SERVICE

NATIONAL OFFICE TECHNICAL ADVICE MEMORANDUM

June 7, 2004

Number: **200437040**
Release Date: 9/10/04
T:EO:B3
UIL: 501.00-00

District Director
M Area
Attn: Chief, EP/EO Division

Taxpayer's Name:

Taxpayer's Address:

Taxpayer's Identification Number:

Years Involved:

Date of Conference: November 26, 2003

Legend:

X=
Y=
A=
B=
C=
D=
E=
F=
G=
H=

J=
K=
L=
M=
N=
O=
R=
S=
$50y=
$55y=
$57y=
$100y=
aaaa=

ISSUES:

(1) Did the X, an organization recognized under section 501(c)(3) of the Internal Revenue Code, have a substantial nonexempt purpose during the years , and, if so, should X's exempt status be revoked?

(2) Have the net earnings of X inured to the benefit of private individuals in contravention of section 501(c)(3) of the Code and, if so, should X's exempt status be revoked?

(3) Did X, a religious organization exempt from federal income tax, intervene in a political campaign in contravention of section 501(c)(3) of the Code when its principal minister made statements in opposition to a candidate for President of the United States and, if so, should its exempt status be revoked?

(4) Is X subject to tax under section 4955 of the Code on amounts expended for political activities?

(5) If X continues to qualify for exemption, should it be classified as a "church" within the meaning of sections 509(a)(1) and 170(b)(1)(A)(i) of the Code?

FACTS:

Background

X was incorporated by A for charitable and religious purposes in

and was recognized by the Service as exempt from federal income tax under section 501(a) of the Code as an organization described in section 501(c)(3) in a letter dated December 20, .

In X amended its articles of incorporation to state that it was a church. It was subsequently ruled that X qualified as an organization described in IRC section 170(b)(1)(A)(i), as a church. At that time, X owned and operated a building in Y, which it used to conduct regular religious services three or four times a week. These services were regularly conducted by the ministry for congregations consisting of 50 to 350 persons.

In the years in issue, X no longer conducted regular religious services throughout the year, though it appears an unknown number were conducted on a seasonal basis. It conducted an unknown number of discussion groups and counseling sessions at a ranch it owns near Z, often for prescribed, substantial hourly or daily fees. It also conducted an average of approximately seven seminars each year in the United States, at which A or H lectured and provided instruction on X's views and doctrines. Substantial set fees were also charged for these sessions. In addition, X produced a B, "C," during which A disseminated X's views, counseled the audience, and raised funds. The B was broadcast weekly—and sometimes daily—in many areas of the United States.

X maintains an active K. It also sells books and tapes authored by A, requests donations, solicits subscriptions to its newsletter, and provides other related information. It does not mention any religious services, regular or sporadic, that would be conducted in an associational or congregational format.

X owned substantial real estate properties, and also invested substantial funds in a for-profit subsidiary engaged in a totally secular business.

During the years under examination, the Board of Directors of X consisted of A, his wife, and several members of his immediate family. All were ordained ministers of X.

X's financial statements revealed the following expenditures for the years :

Category	Expenditures For	Percent of Total
Administrative	$	28%
Office expenses	$	6%
Publications	$	3%
Broadcasting	$	50%
Miscellaneous	$	9%
Equipment & Maintenance	$	4%

Category	Expenditures For	Percent of Total
Administrative	$	27%
Office expenses	$	4%
Publications	$	2%
Broadcasting	$	49%
Miscellaneous	$	14%
Equipment & Maintenance	$	4%

Category	Expenditures For	Percent of Total
Administrative	$	24%
Office expenses	$	3%
Publications	$	3%
Broadcasting	$	45%
Miscellaneous	$	22%
Equipment & Maintenance	$	3%

Additional Findings: Nonexempt Purposes

In the years in issue, X's broadcasting and publications activities ran substantial operating deficits. In , X sold a valuable asset for $ y. In an effort to cover X's operating deficits and expand its exempt activities, it invested the $ y, over a period of several years, in a for-profit subsidiary that carried on a wholly secular activity. In the years in issue, and apparently for some years thereafter, this subsidiary suffered net operating losses. At the same time, the subsidiary grew rapidly, and is claimed to have a value that is several times the amount invested. The subsidiary provided some services to X's exempt activities, for which the subsidiary was paid a monthly fee. However, most of the subsidiary's activities have been solely secular and commercial.

The subsidiary's directors have been and continue to be A, his spouse, their two sons, and D, who appears not to be related to A's family. D has been responsible for the subsidiary's daily operations since at least early , with E serving as the organization's chief executive officer.

During the years in issue and continuing to the present time, the subsidiary has concentrated on expanding its activities and increasing its value. The record does not indicate any efforts to sell all or part of this business.

X's bylaws are structured so that the above-described financial gains will always be at the disposal of the family of A. The bylaws provide:

> "Upon the death of A, the place of the Founder…shall be taken by F, in which capacity she shall serve for the duration of her life. If she is then predeceased, or upon her death, the Office of the Founder shall consist of five members: [her children]. In the event of the death or resignation of a member of the Office of the Founder, the remaining members of the office shall…select a new member from among the descendents of A and F."

CHURCH STATUS:

X is not listed among the local churches on web sites promoting the O. Moreover, it is not listed in the local Yellow Pages telephone directory under "Churches," "Counseling," or "Meditation." And, although X's counsel has contended that its ministers have performed hundreds of weddings and funerals since , it does not appear that they conducted more than five per year during the period. Neither X nor its full-time or part-time ministers apparently keep sufficient records of such events that would prove otherwise.

X does not have a school for ordaining ministers. There is no evidence that A was ordained by a recognized religious body. X ministers perform a "personal tutelage" with A for an indefinite period. The record contains no evidence of the nature of this "personal tutelage", or whether it has any order or structure. Since it was formed in , X has formally "ordained"

ministers, including A and of his family members. The agent asked for but did not receive a copy of the ordination certificate for the remaining minister, who operates X's fee-for-service counseling program.

Nor do the part-time ministers have clearly defined religious duties. In addition to his work with X's subsidiary, E counsels, is licensed to perform marriages, reviews financial data, and assists his father. F arranges seminars, signs checks, opens mail, and helps her husband. G and H counsel, write the newsletter, monitor X's vehicles, and host B when their father isn't available.

X does not own or control any buildings where regular church services are conducted. It sold its church buildings in Y and O during the early s.

After the instant examination had begun, X placed an advertisement in a local Z newspaper asking its followers to meet on March 2, aaaa. In March aaaa, (after the examination had begun), 66 individuals submitted declarations certifying that each was "a follower of and adhere to the principles of" X. Approximately 45 wrote comments about seminars and/or counseling activities; 15 signers said that church meetings were an X activity; and a few said there were Sunday church services.

At the same time, X also provided a petition-like statement signed by 125 persons, of whom 50 had signed the above-described Declarations. The petition stated that the signatories were "adherents and associates" in X, and that the signatories "believe in the precepts taught by A, for our sacerdotal needs, weddings, funerals, and for personal counseling."

X claims that several thousand prisoners are among the audience for his C program, and these should be counted as his congregants since the prisoners are not free to attend X services.

INUREMENT:

During the years in question, A and adult members of his family served as ministers of X. The examination agent does not argue that the salaries and parsonage allowances of these ministers constituted unreasonable compensation.

The only items in dispute are various expenditures made by X which allegedly personally benefited A and members of his family. All of these expenditures are also alleged to constitute automatic excess benefits under Section 4958 of the Internal Revenue Code. Appropriate deficiencies have been asserted under Section 4958 to cover these automatic excess benefits. Accordingly, we do not think that these benefits constitute a basis for revocation of exemption.

POLITICAL ACTIVITIES:

On July 31, , A told the audience of C, an official B sponsored by X, that they should not vote for candidate S, a major political party's prospective nominee for president of the United States in the general

election. In doing so, A impliedly endorsed the candidacy of S's major party opponent for the presidency. A stated without qualification or disclaimer, that it would be "dangerous" to the country if S were elected President.

On September 15, , in the midst of the general election campaign, A again told listeners to C that S should not be elected president of the United States. He also stated that elected official R needed to be voted out of office. A again failed to issue a disclaimer indicating that the views were his own and not those of X.

C was disseminated—and continues to be disseminated--throughout the country. It is intended to provide advice to its audience, and also to raise funds for X.

C is identified by X at location N as officially sponsored by X, with A as its spokesman. The N urges visitors to tune in to C, and helps them identify local or regional stations that carry the B and determine when it is broadcast. The N also allows individuals to access past Bs, including the ones on which A commented on the presidential election.

A's counsel initially contended that broadcasts of the C reflect A's own opinions and teachings and are "predominately reflective" of X's doctrine. However, counsel observed that not every statement on every broadcast is made in A's capacity as a representative or minister of X. "In isolated cases, broadcasted statements of [A] may reflect his own individual opinions and therefore do not constitute part of the activities of X."

Asked to explain why A's July 31 and September 15, , comments did not constitute opposition to S, counsel maintained that the statements were not intended to influence the outcome of the election, and provided "no encouragement of any kind to vote for any particular candidate." Counsel asserted that in context, A's statements sought to help listeners deal with stress and chaos in their lives and help them make moral decisions. Counsel remarked that A sometimes uses public figures, including elected officials and senior members of the government, to illustrate certain moral principles. "The context makes it clear that individual morality and societal values were at stake, not the outcome of an election."

On April 30, 2003, A's counsel stated that A had acknowledged it was improper to mention S during the September 15 L broadcast of C. He again

cited the context of the remarks, which he said were not intended to encourage people to vote against S or to endorse any other candidate. "Nevertheless, because some people may have inferred from [A's] comments that [X] disapproved of [S], [A] has acknowledged that these statements were inappropriate." Nine days later, on May 8, 2003, X's board of directors adopted a policy statement against political intervention.

CODE AND REGULATIONS:

Section 501(a) of the Code provides for the exemption from federal income tax of organizations described in section 501(c)(3) of the Code.

Section 1.501(a)-(1)(c) of the Income Tax Regulations states that the words "private shareholder or individual" in section 501 refer to persons having a personal and private interest in the activities of the organization.

Section 501(c)(3) of the Code provides, in part, for the exemption of organizations that are organized and operated exclusively for religious, charitable, or educational purposes, no part of the net earnings of which inures to the benefit of any private shareholder or individual, no substantial part of the activities of which is carrying on propaganda, or otherwise attempting to influence legislation, (except as otherwise provided in subsection (h)), and which does not participate in, or intervene in (including the publishing or distributing of statements), any political campaign on behalf of (or in opposition to) any candidate for public office.

Section 1.501(c)(3)-1(a)(1) of the regulations provides that in order to be exempt as an organization described in section 501(c)(3), an organization must be organized and operated exclusively for one or more of the purposes specified in that section. If an organization fails to meet either the organizational or the operational test, it is not exempt.

Section 1.501(c)(3)-1(c)(1) of the regulations provides that an organization will be regarded as "operated exclusively" for one or more exempt purposes only if it engages primarily in activities which accomplish one or more of such exempt purposes specified in section 501(c)(3). An organization will not be so regarded if more than an insubstantial part of its activities is not in furtherance of an exempt purpose.

Section 1.501(c)(3)-1(c)(2) of the regulations provides that an organization is not operated exclusively for one or more exempt purposes if its net earnings inure in whole or in part to the benefit of private shareholders or individuals. For the definition of the words "private shareholder or individual" the regulations refer to paragraph (c) of section 1.501(a)-1.

Section 1.501(c)(3)-1(d)(1)(i) of the regulations states that an organization may be exempt as an organization described in section 501(c)(3) of the Code if it is organized and operated exclusively for one of more of the following purposes: religious, charitable, scientific, testing for public safety, literary, educational, or prevention of cruelty to children or animals.

Section 1.501(c)(3)-1(d)(1)(ii) of the regulations provides that an organization is not organized or operated exclusively for one or more exempt purposes unless it serves a public rather than a private interest. Thus, it is necessary for an organization to establish that it is not organized or operated for the benefit of private interests such as designated individuals, the creator or his family, shareholders of the organization, or persons controlled, directly or indirectly, by such private interests.

Section 509(a)(1) of the Code excludes from the term "private foundation" organizations described in section 170(b)(1)(A) (other than in clauses vii and viii). Section 170(b)(1)(A)(i) refers to "a church or a convention or association of churches."

Section 4955(a) of the Code imposes on section 501(c)(3) organizations a tax equal to 10 percent of the amount of each political expenditure, to be paid by the organization. In addition, it imposes on the organization's manager a tax of 2.50 percent of the value of the political expenditure, to be paid by the manager. The statute provides an exception from this requirement when the manager's agreement to make the political expenditure was not willful and is due to reasonable cause.

Section 4955(b) of the Code provides that in any case in which an initial tax is imposed on a political expenditure by a section 501(c)(3) organization, and such expenditure is not corrected within the taxable period, a 100 percent tax on the amount of the expenditure is imposed on the organization. A similar tax of 50 percent of the amount of the political expenditure is

imposed on the organization's manager. These taxes are to be paid by the organization and the manager, respectively.

Section 4955(c) of the Code limits the maximum tax due for each political expenditure from the organization manager to $5,000 under section 4955(a), and $10,000 under section 4955(b). Liability is joint and several if there is more than one person responsible for making the political expenditure.

Section 4955(d) defines a "political expenditure" as any amount paid or incurred by a section 501(c)(3) organization in any participation in, or intervention in (including the publication or distribution of statements) any political campaign on behalf of (or in opposition to) any candidate for public office.

Section 53.4955-1(b)(4)(i) of the Foundation and Similar Excise Tax Regulations provides that an organization manager is considered to have known that an expenditure to which he agreed is a political expenditure if (1) he has actual knowledge of sufficient facts so that solely based on these facts, the expenditure would be a political expenditure; (2) he is aware that such an expenditure under the circumstances may violate federal tax law governing political expenditures; and (3) he negligently fails to make reasonable attempts to ascertain whether the expenditure is a political expenditure, or is aware that it was a political expenditure.

ANALYSIS:

Issue 1

The first issue is whether X's accumulation of over $ y in assets, including $ y in real and commercial property, and $ y loaned to its subsidiary, constituted a substantial nonexempt purpose.

The presence of a single substantial nonexempt purpose can destroy an exemption regardless of the number or importance of an organization's exempt purposes. Better Business Bureau v. United States, 326 U.S. 279, 283 (1945); Schoger Foundation v. Commissioner, 76 T.C. 380 (1981); American Campaign Academy v. Commissioner, 92 T.C. 1053, 1065 (1989); Orange County Agricultural Society, Inc. v. Commissioner, 893 F.2d 529 (2nd Cir. 1990).

In Presbyterian and Reformed Publishing Co. v. Commissioner, 743 F.2d 148 (3rd Cir. 1984), the U.S. Court of Appeals for the Third Circuit considered the section 501(c)(3) status of a closely held organization that was earning substantial profits from religious publishing activities and was accumulating them rather than spending them for charitable purposes. The court held that in determining whether the generation and accumulation of such profits indicated a substantial nonexempt purpose, the same test for reasonableness of accumulations should be used as is set forth under the accumulated earning tax. The court quoted Section 1.537-1(b)(1) of the Regulations, which sets forth the rules for determining when accumulations of earnings and profits are necessary for the reasonably anticipated needs of a taxable business:

> In order for a corporation to justify an accumulation of earnings and profits for reasonably anticipated future needs, there must be an indication that the future needs of the business require such accumulation, and the corporation must have specific, definite and feasible plans for the use of such accumulation. Such an accumulation need not be used immediately, nor must the plans for its use be consummated with a short period after the close of the taxable year, provided that such accumulation will be used within a reasonable time depending upon all the facts and circumstances relating to the future need of the business. Where the future needs of the business are uncertain or vague, where the plans for the future use of accumulation are not specific, definite and feasible, or where the execution of such a plan is postponed indefinitely, an accumulation cannot be justified on the grounds of reasonably anticipated needs of the business."

The court went on to find that the organization had specific plans to construct a new building that would meet its growing needs, and that the profits resulted from the unexpected popularity of one of its books.

This regulation has been interpreted and applied hundreds of times. For example, in Eyefull Incorporated v. Commissioner, T.C. Memo 1996-238, the court aptly summarized the law as follows:

> In order to justify to justify an accumulation for reasonably anticipated future needs, in general, the corporation must demonstrate

> a need warranting such accumulation and the existence, as of the end of the relevant taxable year, of specific, definite and feasible plans to use the accumulation within a reason able time to meet this need. In recognition of the informality which commonly characterizes planning within a closely held corporation, neither the regulations nor the cases require meticulously drawn formal blueprints for actions. . . . But where such documentation is lacking, the intention to dedicate corporate resources to identified business needs must be unambiguously evidenced by some contemporaneous course of action toward this end. . . .

Similarly, in Snow Manufacturing Co. v. Commissioner, 80 T.C. 260,273((1986), the court stated:

> In order for a corporation to justify an accumulation of earning and profits for reasonably anticipated future needs, there must be an indication that the future needs of the business require such accumulation, and the corporation must have specific, definite and feasible plans for the use of such accumulation. Such an accumulation need not be used immediately, nor must the plans for its use be consummated within a short period after the close of the taxable year, provided that such accumulation will be used within a reasonable time depending upon all the facts and circumstances relating to the future needs of the business. Where the future needs of the business are uncertain or vague, where the plans for the future use of an accumulation are not specific, definite and feasible, or where the execution of such a plan is postponed indefinitely, an accumulation cannot be justified on the grounds of reasonably anticipated needs of the business.

In Incorporated Trustees of Gospel Worker Soc'y v. United States, 510 F. Supp. 374 (D.D.C. 1981), aff'd, 672 F. 2d 894 (D.C. Cir., 1981), a closely held religious organization accumulated over $5 million, while its exempt activities declined to a claimed $500,000 in expenditures per year. The Court revoked the exemption, stating:

> While it is theoretically conceivable that the religious purpose may underlie the enormous accumulation of profits since 1970, the sheer size of the surplus and the lack of anything more concrete than the

word of plaintiff's officers as to its future use militates against such a finding.

In Church of Scientology v. Commissioner, 83 T.C. 381, 489 and fn. 8 (1984), aff'd. 823 F/ 2d 1310 (9th Cir. 1987), the U.S. Tax Court held that the presence of substantial reserves, and the failure of the taxpayer to prove a charitable purpose for such reserves, indicated that it had a substantial nonexempt purpose. On appeal, the Ninth Circuit held that several million dollars held in a trust under the founder's legal control, purportedly for the benefit of the church, constituted prohibited inurement to the founder. Id., 823 F. 2d at 1318.

In United Missionary Aviation v. Commissioner, T.C. Memo 1990-566, a closely held religious organization whose activities were designed to support Christian missionaries sold religious audio tapes and related equipment. Its net worth derived from these sales grew from $343.00 in 1969 to $321,958 in 1975. The court held that this accumulation evidenced a substantial nonexempt purpose because the organization failed to give notice of the reason for the accumulation, and because the accumulated profits were designed to expand the unrelated audio tape and equipment business rather than for charitable and religious purposes.

In Easter House v. United States, 12 Cl. Ct. 476, 488 (Cl. Ct. 1987), aff'd per curiam, 846 F. 2d 78 (Fed. Cir. 1988), the court held that, where the founding and controlling life member of a charitable organization made loans to other nonprofits which he de facto controlled, the charitable purposes of the loans must be clearly substantiated.

In a case such as this, where very substantial assets are being accumulated, and where the organization is totally controlled by the founder and his immediate family, X bears a very heavy burden to be forthcoming and explicit about its plans for the use of these assets for charitable or religious purposes. As the Tax Court stated in Bubbling Well Church of Universal Love v. Commissioner, 74 T.C. 531, 535 (1980), aff'd, 670 F. 2d 104 (9th Cir. 1981):

> Preliminarily we note that petitioner, at all pertinent times, was completely dominated by the Harberts family -- a father, mother, and son. Because they were the only voting members and they composed the board of directors, the Harberts were in a position to

> perpetuate this control of petitioner's operations and activities indefinitely. Petitioner had no affiliation with any denomination or ecclesiastical body and, therefore, the Harberts family was not subject to any outside interference or influence in the control of petitioner's affairs. This means that the Harberts, without challenge, could dictate petitioner's program and operation, prepare its budget, and spend its funds, and could continue to do so indefinitely.
>
> . . . While this domination of petitioner by the three Harberts, alone may not necessarily disqualify it for exemption, it provides an obvious opportunity for abuse of the claimed tax-exempt status. It calls for open and candid disclosure of all facts bearing upon petitioner's organization, operations, and finances so that the Court, should it uphold the claimed exemption, can be assured that it is not sanctioning an abuse of the revenue laws. If such disclosure is not made, the logical inference is that the facts, if disclosed, would show that petitioner fails to meet the requirements of section 501(c)(3).

In the instant case, A has total control over both X and it's subsidiary for life. It is therefore incumbent upon X to provide contemporaneous and clear evidence of charitable purpose when it accumulates substantial investment and commercial assets.

While the instant case is close, we think that X has provided sufficient information as to its needs and reasonably anticipated needs for its accumulations—at least during the three years ( ) in issue. For several years, X operated its tax-exempt programs at substantial deficits, and the income from the investment real estate was available to cover the deficits.

There was some evidence that X planned to expand its religious broadcasting activity, and that its investments in its subsidiary were designed to facilitate that expansion in various ways. In the years in issue, the subsidiary provided certain services that assisted the carrying on of the C broadcasts, even though the subsidiary ran annual operating deficits.

In post-audit years, it appears that the subsidiary grew rapidly—perhaps beyond X's expectations. It is now worth several times X's investment in the subsidiary, although it apparently had not earned an

operating profit through . This growth presents a continuing obligation on X to translate this valuable asset into funds, and use those funds for the expansion of its charitable religious activities. For example, X may have to give consideration to selling some of the subsidiary's assets, or selling a portion of the stock of the subsidiary, to an unrelated party. The proceeds of such transactions must be used to fund or expand X's charitable or religious activities. The subsidiary should give highest priority to repaying X's investment loans once it begins generating cash flow or earnings and profits, so that these funds can be used for X's charitable or religious activities. X cannot be allowed to focus its energies on expanding its subsidiary's commercial business and assets, and neglect to translate that financial success into specific, definite and feasible plans for the expansion of its charitable religious activities. Moreover, plans for such expansion are not sufficient. In the near future, X will have to demonstrate that at least some of its plans have been implemented. Snow Manufacturing Co. v. Commissioner, 86 T.C. 260, 273 (1986). A church has a substantial nonexempt purpose where the majority of its funds are devoted to investment or commercial activities without any feasible plan for using the gains from such investments for charitable or religious purposes. See Western Catholic Church v. Commissioner, 73 T.C. 196, 212-213 (1979).

The fact that the assets are being accumulated in a for-profit company under the formal legal control of X does not excuse X from using such assets for charitable religious purposes. Excess accumulations maintained in a subsidiary entity under legal control of the exempt organization, but under the de facto control of the founder, are deemed to be for the founder's personal purposes if no exempt purpose is documented or implemented. Airlie Foundation v. United States, 826 F.Supp. 537, 551 (D.D.C. 1993), 55 F.3d 684 (D.C.Cir. 1995). If the founder's control is complete and there is no exempt purpose, it matters not whether the funds are kept in an entity legally controlled by the organization but de facto controlled by the founder (Airlie Foundation v. United States, supra; Church of Scientology v. Commissioner, supra), or a safe under the founder's control (Church of Scientology v. Commissioner, supra); or in other nonprofits controlled by the founder (Easter House v. United States, 12 Cl. Ct. 476, 488 (Cl. Ct. 1987), aff'd, 846 F.2d 78 (Fed. Cir. 1987) (founder used organization's funds to loan to other nonprofits de facto controlled by himself).

Small, closely controlled exempt organizations—and especially those that are closely controlled by members of one family—with related business

entities require thorough examination to insure that the arrangements serve charitable purposes rather than private interests. Qualifying for exemption is a facts and circumstances test. There is nothing that precludes an organization that is closely controlled or has related for-profit organizations from qualifying, or continuing to qualify, for exemption. However, the lack of institutional protections, that is, a board of directors comprised of active, disinterested persons, and the potential for such organizations to be abused requires IRS to closely examine actual operations to analyze whether they continue to serve exclusively charitable purposes. Further, the fact that IRS has concluded that a closely held organization has operated so as to continue to qualify for exemption does not guarantee that it will continue to do so in the future.

Accordingly, counsel to closely held organizations should take care to ensure that for-profit subsidiaries are not being used to divert exempt organization financial assets, resources, and income to the founding families and other insiders. IRS may examine ongoing activities to verify that there is a plan for using income and assets generated by subsidiaries for the organization's underlying exempt purposes. De minimis levels of exempt activities, millions of dollars in unsecured loans to closely controlled affiliates, with or without formal repayment arrangements, and/or failures to create and implement documented plans for asset accumulations to be used for exempt purposes are likely to be subject to further—and detailed--IRS scrutiny.

Issue 2—Inurement

In the Facts above, we have noted that the examination agents do not contend that the salaries and parsonage allowances of A and the other X ministers constituted unreasonable compensation. Since certain expenditures have been taxed as automatic excess benefits under Section 4958, revocation of exemption is not appropriate here.

Issues 3 and 4—Prohibited 501(c)(3) campaign intervention and IRC 4955

X maintains that A's statements during X's broadcasts concerning presidential candidate S did not constitute intervention by X in a political campaign on behalf of, or in opposition to, a candidate for public office. X

asserts that (1) A's statements were taken out of context; (2) the statements reflected A's personal views and not those of X; and (3) the political activity, even if a technical violation, was insubstantial given the overall volume of statements made by A and disseminated through books, pamphlets, audio and videotapes, and C.

In United States v. Dykema, 666 F.2d 1096, 1101 (7th Cir 1981), the U.S. Court of Appeals for the Seventh Circuit observed that the statutory prohibition against political campaign activities by charitable organizations includes four elements:

(1) a charitable organization may not "participate" or "intervene" in a political campaign;
(2) the political activity involved is a "political campaign;"
(3) the campaign must involve an individual who is a "candidate;"
(4) the individual must be a candidate for a "public office."

In Christian Echoes National Ministry, Inc. v. United States, 470 F.2d 849 (10th Cir. 1972), the U.S. Court of Appeals for the Tenth Circuit held that a religious ministry organization did not qualify for a tax exemption because it participated in legislative activities and intervened in political campaigns. The court found that the organization's publications and broadcasts attacked candidates for public office, including candidates for Congress and the presidency, that the organization considered to be too liberal. "These attempts to elect or defeat certain political leaders reflected…[an] objective to change the composition of the federal government," the court concluded.

With respect to X's first argument, section 1.501(c)(3)-1(c)(3)(iii) of the Income Tax Regulations states that, "[t]he term 'candidate for public office' means an individual who offers himself, or is proposed by others, as a contestant for an elective public office, whether such office be national, State, or local." In July , S was a candidate within the broad outline of the regulation. One need not be a party nominee or run an organized political campaign to be a candidate for public office. See Association of the Bar of the City of New York v. Commissioner, 858 F. 2d 876 (2nd Cir. 1988), wherein the court, quoting Norris v. United States, 86 F. 2d 379, 382 (8th Cir. 1936), stated:

> "[A] campaign for a public office in a public election merely and simply means running for office, or candidacy for office, as the word is used in common parlance and as it is understood by the man in the street."

Further, if S were not a candidate for President, it is unlikely that A would have made statements opposing his candidacy or telling listeners of the C not to support him. Moreover, as of September 15, , S was a major political party's nominee for the office of the presidency of the United States.

X states that A's statements—at least those made on July 31, -- were taken out of context, and that A was seeking to guide people in dealing with the stress and chaos of their lives. X has also taken the position that A's statements were not intended to influence listeners in how they voted, and were not intended as an endorsement of S's political opponents.

X's characterizations of A's statements are not persuasive. The express language used by A, that it would be "dangerous to be an American" and that he would likely "go into exile if S were elected," are clear statements in opposition to a candidate. There is no context in which these statements can be interpreted as guidance to individuals in dealing with the stress and chaos of their lives. To the extent that the statements were intended to guide these individuals to deal with stress and chaos, it was by voting against S. Thus, A's statements made on July 31, on behalf of X were clearly and unequivocally intended to influence listeners of C on how to vote in the presidential election.

The second argument concerns a religious organization's responsibilities for the acts of its ministers. Where an official publication or L program of the organization contains the organization's opposition to a candidate, the statement of opposition should be imputed to the organization, particularly when the statement is represented to reflect the views of the minister. A religious organization's publications and the acts of the minister at official functions of the organization are the principal means by which an organization communicates its official views to its members. It is, therefore, evident that the statements made by the minister on the organization's official L program should be imputed to the organization. The only exception would be where the organization has clearly informed the members prior to the act that the publication or L program does not speak

for the organization and the organization does not utilize either the minister or the publication to generally represent the views of the organization. Thus, A's opposition to S should be imputed to X since A was a minister of X, and the statement of opposition to S (and implied endorsement of his principal opponent) was contained in an official L program of X.

X further argues that even if there was a technical violation of the prohibition against political activity, it was insubstantial. However, section 501(c)(3) does not require political campaign intervention to be substantial before it affects eligibility for exemption. Congress has indicated that the prohibition on political campaign intervention is virtually absolute, unless the activity "was unintentional and involved only a small amount and the organization subsequently had adopted procedures to assure that similar expenditures would not be made in the future." House Budget Comm. Report (H.R. Rep. No 100-391, 100th Cong., 1st Sess 1623-1624 (1987)).

In the instant case, there is no evidence in the record demonstrating that A's two statements were unintentional. There is no evidence that A attempted to excise the statements in taped rebroadcasts of C. Moreover, measures were not promptly taken to correct the interventions. Indeed, A did not clearly and unequivocally acknowledge that his intervention statement might have been inappropriate until April . Further, X's board of directors did not adopt a policy against such political intervention until several days after that. At that time, the audit of X had already begun.

Moreover, the statements were not the type of slip-of-the-tongue variety that might indicate an unintentional character. On the contrary, the statements made by A on the July 31 and September 15, X broadcasts were forceful and clear. A's allegations that Americans would be in danger if S becomes president, that S was a dupe who would betray the nation to its enemies, including a Communist nation (China), were clearly designed to denigrate S's integrity and patriotism, to generate anger and resentment against him, and ultimately to persuade listeners not to vote for him.

Congress enacted section 4955 not so much as an intermediate sanction to replace revocation, but primarily as an additional tax, and secondarily, as a sanction to apply instead of revocation in certain limited situations. H. R. Rep. No. 100-39, supra. Congress was concerned that revocation might be

an ineffective remedy in some cases, such as if the section 501(c)(3) organization ceased operations after diverting all its assets to improper purposes. Therefore, section 4955 applies to section 501(c)(3) organizations regardless of whether their tax-exempt status is revoked. See H.R. Rep. supra.

X made an "expenditure" when it purchased broadcast airtime, either with cash or through a barter arrangement, for its C L shows broadcast on July 31 and September 15, . Those expenditures became "political expenditures" within the meaning of section 4955 when A made and distributed over the airwaves a series of statements, imputed to X, intervening in a political campaign. In particular, those statements constituted intervention in the presidential campaign in opposition to S, a candidate for public office, that is, the presidency of the United States.

Accordingly, X, as a section 501(c)(3) organization, is liable for a tax equal to 10 percent of the amount of each political expenditure under section 4955(a)(1) of the Code. In addition, A, as X's president, leader, and principal spokesman, is an organization manager liable for a tax of 2.50 percent of the value of each political expenditure under section 4955(a)(2). We conclude that he had exclusive control not only of X's decisions related to the purchase of airtime, but also with regard to the editorial content of the C L shows. We find no evidence that to suggest that A's political statements on those shows were not willful or were due to reasonable cause. Accordingly, waiver of the section 4955(a)(2) tax is not warranted.

Given that X is liable for an initial tax imposed on its political expenditures under section 4955(a)(1), we note that such expenditures were not corrected within the applicable taxable period. In fact, A did not clearly and unequivocally acknowledge that his statements about the presidential election might have been inappropriate until April . Moreover, X's board of directors did not adopt a policy against political intervention until several days after that.

Therefore, we find that X is liable for a 100 percent tax on the amount of each political expenditure, as provided in section 4955(b)(1) of the Code. Similarly, A is liable for a tax of 50 percent of the amount of each political expenditure under section 4955(b)(2). We do not believe that any of X's other directors manifested sufficient knowledge to be held jointly and

severally liable with A for the taxes under sections 4955(a)(2) and 4955(b)(2) of the Code.

We conclude that X and A are subject to tax under section 4955 of the Code on amounts expended for political activities.

The question remains whether X's exemption ruling under Section 501(c)(3) should be revoked. The House Budget Committee Report (H.R. Rep. No. 100-391, 100th Cong. 1st Sess. 1623-1624 (1987) explains the relationship between Section 4955 violations and the campaign intervention prohibition in Section 501(c)(3). The report stated that (id.):

> . . . the Internal Revenue Service may hesitate to revoke the exempt status of a charitable organization for engaging in political campaign activities in circumstances where that penalty may seem to be disproportionate- i.e., where the expenditure was unintentional and involved only a small amount and where the organization subsequently had adopted procedures to assure that similar expenditures would not be made in the future. . . .

Similarly, the preamble to the final IRC regulations (T.D. 8628, 60 Fed. Reg. 62,209 (Dec. 5, 1995)) states as follows:

> . . . there may be individual cases where, based on the facts and circumstances such as the nature of political intervention and the measures that may have been taken by the organization to prevent a recurrence, the IRS may exercise its discretion to impose a tax under section 4955 but not to seek revocation of the organization's tax-exempt status.

We believe that the instant case is one where the Service should exercise its discretion to impose only the Section 4955 tax, but not to revoke exempt status. Out of approximately two-hour broadcasts during the presidential election campaign, the political intervention statements constituted only two brief paragraphs. No other political intervention statements during the three years in issue appear to have occurred. The organization has since adopted a policy to prevent recurrences of such statements. The Section 501(c)(3) exemption ruling should not be revoked.

Issue 5—Church Classification

It is useful to consider X's qualification for church classification in light of the various criteria employed by the Service and the courts in deciding whether other organizations are "churches" within the meaning of the Code.

In De La Salle Institute v. United States, 195 F.Supp. 891 (N.D. Cal. 1961) the court examined the activities of an incorporated religious order that operated a winery as well as parochial schools and a novitiate. The court concluded that when Congress used the term "church" it intended to convey a more limited idea than is conveyed by the term "religious organization" and held that the order was not a "church." Noting that certain incidental "church-like" activities could not make the order a church the court stated:

> The chapels at plaintiff's parochial schools and novitiate are "churches." A corporation which did no more than operate one or more of these [chapels] would obviously be a "church" within the meaning of the statutes being interpreted. But plaintiff does much more than this. The operation of the chapels is incidental to plaintiff's principal activities, although very important to plaintiff's members. The tail cannot be permitted to wag the dog.

In Chapman v. Commissioner, 48 T.C. 358 (1967), the Tax Court held that an organization that conducted a Missionary-Dentistry program in foreign countries was not a church. In construing the phrase "church or convention or association of churches" contained in section 170(b)(A)(1)(i) of the Code the court examined the legislative history of section 170(b) and determined that a more limited concept was intended by Congress for the term "church" than that denoted by the term "religious organization." The court stated that Congress did not intend the term "church" to be used in a generic or universal sense, but rather in the sense of a "denomination" or "sect." The Tax Court went on to hold that an evangelical organization whose primary function was to spread the Gospel of Christianity throughout the world was not an organization which could be considered a "church" within the intendment of section 170(b)(1)(A)(i). The court emphasized that (1) the organization's individual members maintained their affiliation with various other churches; (2) the organization was interdenominational and sought converts only to the principles of Christianity generally, rather than

to a specific sect or denomination; (3) the organization did not ordain its own ministers; and, (4) the conducting of religious services by its members was not conclusive per se that the organization was a church.

In American Guidance Foundation v. United States, 490 F. Supp. 304 (D.C. 1980), the court referred to the fourteen criteria which are applied by the Service on an ad hoc basis to individual organizations. The fourteen points are:

1. A distinct legal existence
2. A recognized creed and form of worship
3. A definite and distinct ecclesiastical government
4. A formal code of doctrine and discipline
5. A distinct religious history
6. A membership not associated with any other church or denomination
7. An organization of ordained ministers
8. Ordained ministers selected after completing prescribed studies
9. A literature of its own
10. Established places of worship
11. Regular congregations
12. Regular religious services
13. Sunday schools for religious instruction of the young
14. Schools for the preparation of its ministers.

Referring to these fourteen points, the court in American Guidance stated (id. at 306):

> While some of these are relatively minor, others, e.g. the existence of an established congregation served by an ordained ministry, the provision of regular religious services and religious education for the young, and the dissemination of a doctrinal code, are of central importance.

In Foundation for Human Understanding v. Commissioner, 88 T.C. 1341 (1987), the U.S. Tax Court held that the taxpayer there was a church. The opinion stated that "At a minimum, a church includes a body of believer or communicants that assembles regularly in order to worship. . . . Where bringing people together for worship is only an incidental part of the

activities of a religious organization, those limited activities are insufficient to label the entire organization a church." Id. at 1357.

Thus, both the courts and the Service agree that there is no bright-line test as to whether an organization is a religious organization or a church. Such a determination must be made based on the facts and circumstances of each case.

Both the court in De LaSalle Institute, supra, and the court in Chapman, supra, stated that the conducting of religious services by an organization is not conclusive per se that an organization is a church. The De La Salle Institute court held that the incidental "church-like" activities of the religious teaching order could not make the order a church. The De LaSalle Institute court added that "the tail cannot be permitted to wag the dog." The Chapman court held that while the conducting of religious services by an organization is a factor in the determination of whether an organization is a church, it is not conclusive per se that an organization is a church. Therefore, even if part of X's activities are "church-like" activities, such a fact is not dispositive of the church classification issue.

The current record clearly demonstrates that the critical facts existing when X received its church ruling have dramatically changed. Most important, X no longer possesses the regular church services which have been held to be a prerequisite for church status. It no longer has the "minimum" for church status—"a body of believers or communicants that assembles regularly in order to worship." Foundation for Human Understanding v. Commissioner, supra at 1357. X no longer has a defined congregation of worshipers, nor an established place of worship, nor regular religious services.

Nor does X have other substantial church characteristics. Its "ministers" officiated at no more than weddings or other ministerial events or sacerdotal functions during the years . At most, admittedly "sporadic" lectures, discussions, and counseling sessions, for groups of less than 30 people, were apparently held at a X owned as an investment property. While the documentary evidence was often contradictory, it appears that X staff conducted approximately seminars per year (some of them in other cities), with the majority lasting less than one day. Substantial charges were made for these seminars.

By comparison, for the period under examination, X's broadcasting and publishing expenditures were its principal expenditures. X produced C L programs and disseminated them around the country over numerous stations. When "administrative," "equipment," and "miscellaneous" expenditures are allocated, over 90 percent of X's expenditures were for C, its one L show. Thus the non-associational L show totally dwarfed and eclipsed the de minimis associational activities.

Moreover, this description does not take into account the $ y real estate investment activity, or the roughly $ y in support for the profit-seeking K. As explained above, virtually none of the gain from these businesses was used or programmed for "associational aspects" of X. Instead, all of this gain was devoted to expanding the K, whose mission is to produce, disseminate, and promote programming that in general has nothing to do with religion.

The court's decision in Foundation of Human Understanding v. Commissioner, supra, illustrates that a religious organization may "evolve" into a church over time. Hence, it stands to reason that a church may likewise evolve into an organization that no longer can be considered a church. That evolution occurred here. The examination discovered no evidence that during the period, X had a membership not associated with any other church or denomination, or had an established regular congregation as it did when it held weekly services at its former Y facility during the s. Thus, the customary associational aspects of church worship, involving a body of believers or communicants that assembles regularly in order to worship, are not present in this case.

X's counsel has cited media reports that churches are posting weekly services on their N's or broadcasting them on the L for outreach purposes, and has asserted that a "great number of X's congregants attend and worship by L or N." However, we do not find this argument to be convincing, in part because X no longer conducts weekly services as it did in the s when it received its church ruling. While the C L shows that are aired on the L have some religious content and seek to disseminate X's views and doctrines, religious L programming is not sufficient to constitute a church. Foundation for Human Understanding v. Commissioner, supra; Via v. Commissioner, 68 T.C.M. 212 (1994).

Accordingly, based upon all the facts and circumstances, X is not a church within the meaning of sections 509(a)(1) and 170(b)(1)(A)(i) of the Code. Although X's activities included holding occasional lectures, seminars, and counseling sessions at which religious themes were discussed, X was during the years (and is now) predominately a religious broadcaster and, through its subsidiary, a J. As the court stated in De La Salle Institute, supra, "the tail cannot be permitted to wag the dog."

ISSUE 6:

Although not submitted as a separate issue, we must decide whether X's classification as a church under Section 509(a)(1) should be retroactively modified back to January 1, . An exemption may be modified retroactively if the organization operated in a manner materially different from that originally represented. Treasury Regulations on Procedure and Administration, Sec. 601.201(n)(6)(i); Rev. Proc. 90-28, 1990-1 C.B. 51. At least as early as that date, X had no regular congregation or services, and was engaging in de minimis church activities. See Rev. Proc 2004-4, 2004 I.R.B. 125, Sec. 13. Accordingly, the church ruling under Section 509(a)(1) must be modified retroactively to January 1, .

In the instant case, in X sold its K for $ y. At the same time it began building an even larger K through its subsidiary, and had over $ y in investment real estate. During these years, X had no church building, no regular congregation, and did not conduct regular religious services. These were substantial and material changes from X's activities when it received its church ruling, and justify retroactive modification.

CONCLUSIONS:

(1) X did not have a substantial nonexempt purpose during the years .

(2) X's 501(c)(3) exemption ruling should not be revoked on the basis of prohibited private inurement.

(3) X's 501(c)(3) exemption ruling should not be revoked on the basis of prohibited intervention in political campaigns.

(4) X and A are subject to tax under section 4955 of the Code on amounts expended for political activities.

(5) X should not be classified as a church within the meaning of sections 509(a)(1) and 170(b)(1)(A)(i) of the Code.

(6) Reclassification of X's Section 501(a)(1) church ruling should be retroactive to January 1, .

A copy of the technical advice memorandum is to be given to the organization. Section 6110(j)(3) of the Internal Revenue Code provides that it may not be used or cited by others as precedent.