HOLY PROFITS: HOW FEDERAL LAW ALLOWS FOR THE ABUSE OF THE CHURCH TAX-EXEMPT STATUS

I. THE MEMO TO THE SENATOR

In November of 2007, Senator Charles Grassley of Iowa initiated an investigation of six prominent televangelist leaders of church-based ministries for possible financial misconduct.[1] Acting on tips that some of the ministers were driving luxury cars and purchasing high-priced furniture while taking advantage of the church tax-exempt status, the ranking

1. Justin Juozapavicius, *Sen. Grassley Probes Televangelists' Finances*, WASH. POST, Nov. 7, 2007, http://www.washingtonpost.com/wp-dyn/content/article/2007/11/06/AR2007110601838_pf.html.

Republican on the Senate Finance Committee sent letters to each of the six televangelists and their ministries[2] requesting financial records.[3]

The investigation was met with charges of bias and discrimination from some conservatives and evangelicals, who claimed that Senator Grassley targeted Pentecostal televangelists who preach the "prosperity gospel,"[4] in part because of his Baptist faith.[5] One minister, Kenneth Copeland, launched a website[6] to publicly denounce the investigation, and suggested that the investigation was the result of Satan's work.[7] According to the Senator, however, four ministers were cooperating with the investigation after some initial resistance.[8]

The investigation concluded on January 6, 2011 with a press release and a report regarding the six televangelists.[9] Within the report, Senator Grassley included a memorandum prepared by his staff and addressed to the Senator.[10] The staff writes that, of the six ministries investigated, only two of them fully complied with the investigation throughout its course.[11] Because the rest of them "either did not provide a response or provided incomplete responses," the Senator's staff relied on information gathered from third-party informants and public sources to carry out its

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2. The letters' recipients were as follows: Kenneth Copeland of Kenneth Copeland Ministries; Creflo Dollar of World Changers Church International and Creflo Dollar Ministries; Benny Hinn of World Healing Center Church, Inc. and Benny Hinn Ministries; Bishop Eddie Long of New Birth Missionary Baptist Church and Bishop Eddie Long Ministries; Joyce Meyer of Joyce Meyer Ministries; Randy and Paula White of Without Walls International Church and Paula White Ministries of Tampa. *Id.*

3. *Id.*

4. Jacqueline L. Salmon, *Probe Biased, Televangelists Say*, WASH. POST, May 24, 2008, http://www.washingtonpost.com/wp-dyn/content/article/2008/05/23/AR2008052302679.html. The "prosperity gospel" is a doctrine expounding the theory that "'health and wealth' are the automatic divine right of all Bible-believing Christians and may be procreated by faith as part of the package of salvation, since the Atonement of Christ includes not just the removal of sin, but also the removal of sickness and poverty." Stephen Hunt, *'Winning Ways': Globalisation and the Impact of the Health and Wealth Gospel*, 15 J. CONTEMP. RELIGION 331, 332-33 (2000) (U.K.).

5. Salmon, *supra* note 4.

6. BELIEVERS STAND UNITED (2013), http://believersstandunited.com.

7. Salmon, *supra* note 4.

8. *Id.*

9. Press Release, S. Comm. on Fin., Grassley Releases Review of Tax Issues Raised by Media-based Ministries (Jan. 6, 2011), *available at* http://www.grassley.senate.gov/news/Article.cfm?RenderForPrint=1&customel_dataPageID_1502=30359.

10. Memorandum from Theresa Pattara & Sean Barnett, Staff of S. Fin. Comm., to Sen. Charles Grassley, Sen., S. Fin. Comm. (Jan. 6, 2011) (on file with S. Fin. Comm.), *available at* http://www.finance.senate.gov/newsroom/ranking/download/?id=1f92d378-baa2-440d-9fbd-333cdc5d85fc [hereinafter Grassley Memorandum].

11. *Id.* at 1.

investigation of the remaining four ministers.[12] However, no penalties were assessed on any of the televangelists or their ministries.[13]

After discussing other topics,[14] the Grassley Memorandum addresses several issues regarding the relevant tax code (the "Code") and its effects on churches and ministers.[15] It briefly discusses weaknesses in the Code and its enforcement. The Grassley Memorandum then proposes several modifications to the Code and its regulations.[16] Some of the relevant issues the Grassley Memorandum addresses include the provisions specifically excluding churches from the annual filing requirement mandated for other types of non-profit organizations,[17] the generally ineffective provisions that impose an excise tax on excess benefit transactions,[18] the procedural prerequisites for initiating a church tax inquiry,[19] and the provisions and case law pertaining to parsonage housing and allowances.[20]

Along with the Grassley Memorandum, the staff's report included a detailed review of each of the four uncooperative televangelists' ministries.[21] Each review delved into many

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12. *Id.* Some of the informants were supposedly "too frightened to speak . . . even anonymously," due to legal threats by the churches and fear of retaliation, despite the staff's offer of friendly subpoenas. *Id.* Explanations of the protections of a subpoena could not quell these fears, and the resources to issue and enforce the subpoenas were predicted to be lacking; therefore, no subpoenas were issued.*Id.* at 1-2.

13. Rachel Zoll, *Televangelists Escape Penalty in Senate Inquiry*, USA TODAY, Jan. 7, 2011, http://usatoday30.usatoday.com/news/religion/2011-01-07-evangelists-tv-Senate07_ST_N.htm.

14. Grassley Memorandum, *supra* note 10, at 5-9. The other topics discussed are twofold: 1) a 1977 proposal for stricter regulations on churches that solicit by mail, which prompted the formation of the Evangelical Council for Financial Accountability ("ECFA"); and 2) the summary of the Bakker Scandal, in which Jim Bakker was convicted of fraud and conspiracy after he and Richard Dortch "defraud[ed] as many as 150,000 contributors and divert[ed] more than $4 million for their personal use." *Id.*

15. *Id.* at 10-61. Unless otherwise specified, all section references are to the Internal Revenue Code of 1986, as amended, and the regulations thereunder.

16. *Id.*

17. Grassley Memorandum, *supra* note 10, at 16-34.

18. *Id.* at 37-44.

19. *Id.* at 34-35.

20. *Id.* at 10-16.

21. Staff of S. Fin. Comm., Minority Staff Review of Without Walls International Church Paula White Ministries, *available at* http://www.finance.senate.gov/newsroom/ranking/download/?id=92ca4e4e-4146-4448-9bcc-ebf81631f300; Staff of S. Fin. Comm., Minority Staff Review of New Birth Missionary Baptist Church Bishop Eddie Long Ministries, *available at* http://www.finance.senate.gov/newsroom/ranking/download/?id=7423d1f2-4860-454a-8814-f2f5e646da29; Staff of S. Fin. Comm., Minority Staff Review of World Changers Church Int'l (WCCI), *available at* http://www.finance.senate.gov/newsroom/ranking/download/?id=bedb7313-be71-4bfe-

aspects of the respective ministry, such as its organizational structure, compensation of its ministers and their relatives, transactions with its board members, finances, assets and their usage, published works and royalties, use of donor funds, trips taken by the ministers, and gifts to the ministers.[22] Assets used or owned by the ministers and their spouses include multi-million-dollar residences and multiple private jets.[23] Many of the assets and their usages have gone either unreported or misreported by the ministries.[24]

Senator Grassley, in a letter dated January 5, 2011, requested input from the Evangelical Council for Financial Accountability (ECFA) and asked whether certain issues that the Grassley Memorandum raises could be resolved with non-legislative solutions.[25] ECFA then formed the Commission on Accountability and Policy for Religious Organizations, composed of various religious leaders and experienced attorneys.[26] In December of 2012, the commission released its Commission Report, which addresses many of the concerns raised by Senator Grassley's staff.[27]

This comment will address some of the weaknesses in the Internal Revenue Code and its accompanying Treasury Regulations that allow for practically anyone to operate under the umbrella of the church tax exemption without IRS interference. The comment will provide additional analysis to the

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9eb5-b929710f0fa0; Staff of S. Fin. Comm., Minority Staff Review of Eagle Mountain Int'l Church d/b/a Kenneth Copeland Ministries, *available at* http://www.finance.senate.gov/newsroom/ranking/download/?id=d12db357-ce3f-49f8-babb-4134ff994e50.

22. *See, e.g.*, Review of Eagle Mountain Int'l Church d/b/a Kenneth Copeland Ministries, *supra* note 21.

23. *See* Review of Without Walls Int'l Church Paula White Ministries, *supra* note 21, at 8, 11; Review of New Birth Missionary Baptist Church Bishop Eddie Long Ministries, *supra* note 21, at 7, 18-19; Review of World Changers Church Int'l (WCCI), *supra* note 21, at 9-10; Review of Eagle Mountain Int'l Church d/b/a Kenneth Copeland Ministries, *supra* note 21, at 9, 19-20.

24. *See* Review of Without Walls Int'l Church Paula White Ministries, *supra* note 21, at 6-7; Review of New Birth Missionary Baptist Church Bishop Eddie Long Ministries, *supra* note 21, at 6-7; Review of World Changers Church Int'l (WCCI), *supra* note 21, at 4, 7; Review of Eagle Mountain Int'l Church d/b/a Kenneth Copeland Ministries, *supra* note 21, at 10.

25. Comm' Report, Comm' Accountability and & Policy for Religious Orgs., Enhancing Accountability for the Religious and Broader Nonprofit Sector 87 (2012), *available at* http://religiouspolicycommission.org/CommissionReport.aspx (2012) [hereinafter Commission Report] (attaching Sen. Grassley's letter to Dan Busby). ECFA is an independent organization responsible for accrediting Christian churches and other nonprofit organizations that demonstrate "adherence to specific standards related to good governance, financial integrity, and accountability." *Id.* at 39.

26. *Id.* at 5.

27. *See Id.* at 1; Grassley Memorandum, *supra* note 10, at 2.

potential effects of the Grassley Memorandum's corresponding proposals, and it will consider the Commission Report's suggestions for non-legislative solutions. It will also address some issues raised neither by the Grassley Memorandum nor by the Commission Report.

This comment suggests and analyzes proposals for the stronger enforcement of and penalties for violations of the Internal Revenue Code on those churches committing the violations, whether by fraud or within the safe havens provided by the Code. It does not analyze the constitutional issues regarding any of the Code or regulations, but only mentions some of those issues in passing. Also, this comment does not advocate for the removal or revocation of the tax-exempt status in its entirety, as the author is well aware of the many societal benefits churches provide. In fact, the legitimacy and goals of the compliant churches are strengthened by a more aggressive enforcement of the Code.[28]

II. QUALIFYING FOR SECTION 501(C)(3) STATUS

Before discussing how some churches are able to operate in violation of the Internal Revenue Code and Treasury Regulations without IRS interruption, it is important to understand some of the rules governing nonprofit organizations.

Because churches and other nonprofit organizations provide a benefit to society and promote the public good, Congress exempts such organizations from taxation.[29] Thus, Internal Revenue Code Section 501(c)(3) exempts "corporations and any community chest, fund, or foundation, organized and operated exclusively for religious . . . purposes, . . . no part of the net earnings of which inures to the benefit of any private shareholder or individual."[30] Whether the organization is designated by the state as a tax-exempt organization "bear[s] little or no weight in the section 501(c)(3) analysis."[31]

In accordance with the Code, Treasury Regulations implement the "organizational and operational tests" for determining qualification of an organization, and the failure of

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28. *See* Commission Report, *supra* note 25, at 5 (noting that church leaders' use of church funds for their lavish lifestyles "damages the [church's] credibility and mission" and "impairs the credibility of other similar organizations").

29. I.R.C. § 501(a), (c)(3) (2012); Church of Scientology v. Comm'r, 823 F.2d 1310, 1315-16 (9th Cir. 1987) (citing Presbyterian and Reformed Publ'g Co. v. Comm'r, 743 F.2d 148, 153 (3d Cir. 1984); Harding Hosp., Inc. v. United States, 505 F.2d 1068, 1071 (6th Cir. 1974)).

30. I.R.C. § 501(c)(3).

31. Nonprofits' Ins. Alliance of Cal. v. United States, 32 Fed. Cl. 277, 283 (1994).

one or both tests results in the organization being non-exempt.[32] The organizational test is satisfied if the organization's founding documents limit the organization to only exempt purposes,[33] and if they do not empower the organization to "engage more than an insubstantial part of its activities in conduct that fails to further its charitable goals."[34] The operational test is composed of four elements, and the failure to comply with any one of them will disqualify the organization from eligibility for tax-exempt status.[35]

> First, the organization must engage primarily in activities which accomplish one or more of the exempt purposes specified in § 501(c)(3). Second, the organization's net earnings may not inure to the benefit of private shareholders or individuals. Third, the organization must not expend a substantial part of its resources attempting to influence legislation or political campaigns. Courts have imposed a fourth element. Organizations seeking exemption from taxes must serve a valid public purpose and confer a public benefit.[36]

Whether an organization ultimately qualifies for tax-exempt status is a legal conclusion.[37] However, this conclusion is based upon findings that the organization satisfies the organizational and operational tests, which are factual findings reviewable under the "clearly erroneous" standard.[38]

If more than an "insubstantial part of its activities . . . is not in furtherance of an exempt purpose," the organization is non-exempt.[39] The exact "purposes" are determined by the courts to be those "purpose[s] towards which an organization's activities are directed, and not the nature of the activities themselves."[40] However, the purposes may be inferred from the manner of an

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32. Treas. Reg. § 1.501(c)(3)-1(a) (2008).

33. St. David's Health Care Sys. v. United States, 349 F.3d 232, 234 (5th Cir. 2003) (citing Treas. Reg. § 1.501(c)(3)-1(b)). "Exempt purposes," as relevant here, may include "religious" or "charitable" purposes. Treas. Reg. § 1.501(c)(3)-1(a)(2), (d).

34. *St. David's Health Care*, 349 F.3d at 234.

35. *Church of Scientology*, 823 F.2d at 1315.

36. *Id.* (citations omitted).

37. Church by Mail, Inc. v. Comm'r, 765 F.2d 1387, 1390 (9th Cir. 1985).

38. U.S. CB Radio Ass'n v. Comm'r, 42 T.C.M. (CCH) 1441 (1981) (stating that whether a taxpayer satisfies the organizational test is a factual finding); *Church by Mail*, 765 F.2d at 1390 (stating that whether a taxpayer satisfies the operational test is a factual finding).

39. Christian Stewardship Assistance, Inc. v. Comm'r, 70 T.C. 1037, 1040 (1978).

40. B.S.W. Group, Inc. v. Comm'r, 70 T.C. 352, 356-57 (1978).

organization's operations.[41] Several factors may be considered when the court is making the determination of whether there is a "forbidden predominate purpose," such as "the particular manner in which an organization's activities are conducted, the commercial hue of those activities, and the existence and amount of annual or accumulated profits."[42] The facts and circumstances of a case might show that particular activities accomplish both exempt and non-exempt purposes, thereby toeing the line established by the regulation's operational test between exempt and non-exempt statuses.[43]

An example is a hypothetical megachurch in which the minister preaches the "prosperity gospel."[44] The preacher wishes to catch and retain the attention of the public, as well as gain permanent followers and frequent contributors of his ministry.[45] His or her sermons and teachings are heavily marketed and advertised, and the preaching revolves around the premise that God bestows health and wealth upon Christians.[46] Many times, the minister says, it is necessary to give a significant amount of money to God in order to receive His many blessings and rewards.[47] The resulting contributions build church revenue and increase church visibility.[48] The minister, in turn, generates a separate income due to signing contracts for publishing books, DVDs, and other forms of media, all of which preach the prosperity gospel and have led to the preacher's generating millions of dollars in income.[49]

All other issues aside, the above hypothetical poses some difficultly nuanced and interesting questions regarding the

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41. Nonprofits' Ins. Alliance v. U.S., 32 Fed. Cl. 277, 283 (1994) (citing Living Faith v. Comm'r, 950 F.2d 365, 372 (7th Cir. 1991); Universal Life Church v. U.S., 13 Cl.Ct. 567, 583 (1987); Presbyterian & Reformed Pub. Co. v. Comm'r, 743 F.2d 148, 155 (3d Cir.1984)).

42. *B.S.W. Group, Inc.*, 70 T.C. at 358.

43. *See* Treas. Reg. § 1.501(c)(3)-1(c)(1) (2008).

44. *See* Hunt, *supra* note 4, at 332-333 (defining prosperity gospel).

45. *See* Scott Thumma & Warren Bird, *A New Decade of Megachurches: 2011 Profile of Large Attendance Churches in the United States*, HARTFORD INST. FOR RELIGION RES. 8 (Nov. 22, 2011), *available at* http://www.hartfordinstitute.org/megachurch/New-Decade-of-Megachurches-2011Profile.pdf.

46. *See* David Van Biema & Jeff Chu, *Does God Want You to Be Rich?*, TIME, Sept. 10, 2006, http://content.time.com/time/magazine/article/0,9171,1533448-2,00.html.

47. *Id.*

48. *See* Thumma & Bird, *supra* note 45, at 3.

49. *See* Ivey DeJesus, *Defending Success and Fame: Joel Osteen Says He is Keeping the Faith*, PENNLIVE, (May 28, 2013, 8:04 AM), http://blog.pennlive.com/midstate_impact/print.html?entry=/2013/05/joel_osteen_harrisburg_pennsyl.html; *see also* Ruth Streeter, *Joel Osteen Answers His Critics*, CBSNEWS, (Feb. 11, 2009, 4:03 PM), http://www.cbsnews.com/2102-18560_162-3358652.html.

ministry's activities. One could argue that the purpose of the sermons, services, advertising of such, and even the ministry's mere existence is for the enrichment of the minister. The purpose was the end game, where the minister would have enough followers to profit solely off of non-church activities, and the substantial amount of accumulated profits helps evince this purpose.[50]

As the example shows, the substantive law regarding whether an organization qualifies as a section 501(c)(3) organization can yield differing interpretations.[51] However, the difficult questions posed by applying the substantive law to a given set of facts represent a welcomed stage of the tax code's enforcement. For, as this comment demonstrates, the Code and its regulations contain vexing enforcement provisions that stifle the IRS' ability to initiate an action for even blatant violations of the substantive Code.[52]

III. NO PAPERWORK NECESSARY

A. *The Notification Requirement*

As a prerequisite to being recognized as a tax-exempt organization, an organization must notify the Secretary of the Treasury that the organization is applying for 501(c)(3) status.[53] The same form submitted to apply for tax-exempt status, Form 1023, satisfies this notification requirement.[54]

There are two statutorily mandated exceptions to this notice requirement, one of which includes "churches, their integrated auxiliaries, and conventions or associations of churches."[55] Because churches are excepted from this requirement, the Internal Revenue Service does not have the opportunity to preliminarily evaluate detailed information about a non-applicant's structure, activities, and finances—including past, present and planned.[56]

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50. *See generally* Streeter, *supra* note 49 (describing how the church solicits donations).

51. *See* Treas. Reg. §1.501(c)(3)-1(a)-(f); Church of Scientology v. C.I.R., 823 F.2d 1310 (9th Cir. 1987).

52. *See* discussion *infra* Parts III-VII.

53. I.R.C. § 508(a) (2012); Treas. Reg. § 1.508-1(a)(1)-(2) (1995).

54. Treas. Reg. § 1.508-1(a)(2)(i).

55. I.R.C. § 508(a)(1), (c)(1)(a). The other exception includes non-private foundations for which gross receipts do not normally exceed $5,000. I.R.C. § 508(c)(1)(b).

56. *See* I.R.S. Notice 1382 (Oct. 2012), *available at* http://www.irs.gov/pub/irs-pdf/f1023.pdf.

A completed and submitted Form 1023 for a church would include information regarding compensation of all of its officers, directors and trustees, and of the five highest paid employees.[57] It would also contain information about the familial and business relationships among the church's administrators, reveal whether a policy exists for conflicts of interest, and give information about business agreements made on behalf of the church or any of its administrators.[58]

According to the IRS's Tax Guide for Churches and Religious Organizations, "many" churches submit an application for recognition of their section 501(c)(3) status because the recognition "assures church leaders, members, and contributors that the church is recognized as exempt and qualifies for related tax benefits," such as a tax deduction for charitable contributions.[59] However, the guide's author is the IRS, and the target audience consists of churches;[60] the IRS has reason to encourage the filing of the Form 1023.[61]

Although the U.S. Tax Court has ruled that a donor must prove that the donee qualifies as a 501(c)(3) organization to get a tax deduction,[62] there is no statute or regulation explicitly requiring that the 501(c)(3) status of a church be formally recognized by the IRS in order for a donation to be deductible.[63] In fact, a contributor may deduct the contribution from his or her income, and the contributor merely assumes the "burden of establishing that the church in fact meets the qualifications of a Section 501(c)(3) organization," should he or she be audited.[64]

While the assurances to donors provided by 501(c)(3) status recognition might persuade some churches to apply for tax exemption, it was not persuasive enough to convince any of the six investigated televangelists or their ministries to file the

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57. *See id.* at 2-5.

58. *See id.* at 3-5.

59. IRS, Tax Guide for Churches and Religious Organizations 3, *available at* http://www.irs.gov/pub/irs-pdf/p1828.pdf.

60. *See id.* (stating in its preface that it is intended as a "quick reference guide . . . for churches . . . to help them voluntarily comply with tax rules").

61. *See generally id.* (describing requirements of a tax-exempt organization, all of which encourage transparency in exchange for tax deductions).

62. *See, e.g.*, Stephenson v. Comm'r, 79 T.C. 995, 1002 (1982) ("To get a charitable deduction, [a donor] must prove that the recipient organization qualifie[s]" as a 501(c)(3) organization). *But cf.* Morey v. Riddell, 205 F. Supp. 918, 919, 921 (S.D. Cal. 1962) (allowing a deduction for donations made to a church with no identifying name, charter, bylaws, headquarters, comprehensive records, or bank account for church funds).

63. *See* I.R.C. §§ 170, 501 (2012); Treas. Reg. §§ 1.170A-13 (1996), 1.501(c)(3)-1 (2008).

64. Branch Ministries v. Rossotti, 40 F. Supp. 2d 15, 19-20 (1999).

form.[65] If these six ministries could collect donations on such a large scale without recognition of 501(c)(3) status, there is little reason to believe that the application process is appealing for any church intending to operate outside of regulations.[66] From the perspective of a filer who is establishing a church with that intent, such application would only serve to put the IRS on notice of the church's existence and make a church tax inquiry more probable than without the filing of the Form 1023.[67]

B. *The Annual Return*

Similar to the statutory exemption for churches from the notice requirement, the Internal Revenue Code excepts "churches, their integrated auxiliaries, and conventions or associations of churches" from the requirement of filing an annual return, a return that many other tax-exempt organizations are required to file.[68] The form on which the annual return is filed is Form 990, and, similar to the Form 1023 application, it instructs the organization to disclose an exhaustive amount of financial information, including assets, contributions, and compensation of officers, amongst others.[69] For organizations required to file Form 990 annually, the failure to file this form for three consecutive years results in a revocation of tax-exempt status.[70]

C. *Impact on IRS Enforcement*

These exceptions for churches from filing both the application and annual reporting documents create the possibility of the IRS having no documentation of a church's

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65. Grassley Memorandum, *supra* note 10, at 2.

66. *See e.g.*, Review of Without Walls Int'l Church Paula White Ministries, *supra* note 21, at 6.

67. *See infra* Part VI (referring to church tax inquiry).

68. I.R.C. § 6033(a)(1), (3)(A)(i) (2012). Other exceptions from the filing requirement include limited types of organizations with gross receipts not normally exceeding $25,000 each taxable year, exclusively religious activities of any religious order, and organizations that the Secretary of the Treasury excepts from filing because it would be administratively unnecessary. I.R.C. § 6033(a)(3)(A)-(C); Grassley Memorandum, *supra* note 10, at 16 n.42 (explaining that the IRS increased the $5,000 threshold to $25,000 in 1982).

69. *See* Return of Organization Exempt From Income Tax (OMB No. 1545-0047), 1 (2012), *available at* http://www.irs.gov/pub/irs-pdf/f990.pdf; Application for Recognition of Exemption Under Section 501(c)(3) of the Internal Revenue Code (OMB No. 1545-0056) (Rev. June 2006), *available at* http://www.irs.gov/pub/irs-pdf/f1023.pdf.

70. I.R.C. § 6033(j)(1). An organization whose tax-exempt status was revoked may reapply for reinstatement of the status, and this may be retroactively applied upon showing of "reasonable cause." I.R.C. § 6033(j)(2)-(3).

existence, if the church chooses to take advantage of the exceptions.[71] Because the IRS "relies heavily on the information supplied in the Form 990[,] . . . it is difficult for the IRS to discover and investigate abuses of section 501(c)(3) status by churches that do not choose to seek recognition of tax-exempt status or to file annual returns."[72]

This factor alone severely impedes the IRS's ability to conduct audits of churches abusing their 501(c)(3) statuses and prevents the IRS from properly administering the law.[73] Not only does this situation contribute to a church's ability to operate free from IRS scrutiny despite failing the requirements for tax-exempt status, it also allows for the very real possibility that for-profit entities operate safely under the umbrella of churches by simply claiming they are "integrated auxiliaries"[74] of their respective church—no paperwork necessary.[75]

D. *Keep the Church Exceptions?*

Little was offered in the way of specific reasons for these exceptions when they were enacted.[76] The Commission Report, however, advances many arguments for the preservation of the Form-990 exception.[77]

The Commission Report first raises the constitutional issue of "excessive entanglement,"[78] saying that a new requirement of disclosing detailed information on the Form 990 would "raise serious constitutional questions";[79] but it fails to adequately demonstrate how the imposition of a filing requirement on

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71. Grassley Memorandum, *supra* note 10, at 20-21. The Commission Report notes that churches are in some instances required to file Forms SS-4, 941, W-2, W-3, 1099, and 1096, but these are required only where a church's activities necessitate such filings, and these are "generally related to payments to employees and vendors." Commission Report, *supra* note 25, at 30.

72. Grassley Memorandum, *supra* note 10, at 20.

73. *Id.* at 24 (citing *Federal Tax Rules Applicable to Tax-Exempt Organizations Involving Television Ministries: Hearing Before Subcomm. on Oversight of the H. Comm. on Ways & Means*, 100th Cong. 241 (1987)).

74. See Treas. Reg. § 1.6033-2(h)(3) (2011), for the multiple definitions and factors for determining whether an organization is an "integrated auxiliary" of a church. This is not to say that such churches using this distinction would prevail in a hypothetical suit by the IRS, but it does provide a theoretical hurdle the IRS must clear to obtain a judgment. *Id.*

75. Grassley Memorandum, *supra* note 10, at 28-30.

76. *See* H.R. REP. NO. 91-113, pt. 4, at 36-37 (1969); S. REP. NO. 91-552, pt. 4, at 52-53 (1969).

77. Commission Report, *supra* note 25, at 29-36.

78. Walz v. Tax Comm'n of N.Y., 397 U.S. 664, 674 (1970) (basing the prohibition on church-state entanglement on the U.S. Constitution's First Amendment).

79. Commission Report, *supra* note 25, at 31-32.

churches would result in "favoring" or "discriminating" among churches or their religious beliefs.[80] Anticipating the "excessive entanglement" argument, the Grassley Memorandum asserts that entanglement is, in fact, more likely to occur with the *status quo*.[81] Because the Internal Revenue Code does not define the word "church," the IRS has more discretion in its determination of which organizations qualify as churches.[82] Such a system can result in preferential treatment for some more traditional and societally accepted religious doctrines and practices, while relatively newer religions may have a higher risk of being subject to IRS enforcement.[83] Thus, the argument that requiring churches to file an annual return would result in entanglement is unpersuasive.[84]

Both the Commission Report and the Grassley Memorandum agree that the filing of the Form 990 would "unnecessarily burden the overwhelming majority of churches, particularly those that are already financially challenged . . . ."[85] However, in 2007, the IRS implemented the Form 990-N, also referred to as the "e-postcard," for small, tax-exempt organizations.[86] As of now, it requires only basic information regarding the organization's (and its principal officer's) name and contact information.[87] The Commission Report rejects the idea of a Form 990 filing requirement by citing the IRS' broad discretion to later expand the form.[88] However, the Form 990-N may be

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80. *See id.* at 31-32.

81. Grassley Memorandum, *supra* note 10, at 26-28.

82. *Id.* (citing *Federal Tax Rules Applicable to Tax-Exempt Organizations Involving Television Ministries: Hearing Before Subcomm. on Oversight of the H. Comm. on Ways & Means*, 100th Cong. 153 (1987) [hereinafter Tax-Exemption Hearings]). The Grassley Memorandum based its argument in part on testimony from Reverend Oral Roberts, in which he questioned the logic behind requiring his non-church religious organization (the Oral Roberts Ministry) to file the annual return, while other churches are not required to do the same. *Id.* at 26-27. Regarding the testimony, the Grassley Memorandum was quick to point out that Oral Roberts supported not the elimination of the Oral Roberts Ministry's filing requirement, but the implementation of the filing requirement on churches. *Id.*

83. *See* Grassley Memorandum, *supra* note 10, at 26-28 (citing Found. of Human Understanding v. United States, 88 Fed. Cl. 203, 217 (2009)).

84. *See id.*

85. Commission Report, *supra* note 25, at 34; Grassley Memorandum, *supra* note 10, at 32.

86. *Annual Electronic Filing Requirement for Small Exempt Organizations — Form 990-N (e-Postcard)*, IRS, available at http://www.irs.gov/Charities-&-Non-Profits/Annual-Electronic-Filing-Requirement-for-Small-Exempt-Organizations-Form-990-N-(e-Postcard) (last updated Apr. 15, 2013) [hereinafter Information Reported on Form 990-N].

87. Information Needed to File e-postcard, IRS, available at http://www.irs.gov/Charities-&-Non-Profits/Information-Needed-to-File-e-Postcard (last updated Mar. 7, 2013).

88. Commission Report, *supra* note 25, at 34.

greatly expanded while still remaining a middle ground between the current lack of filing requirement and the Form 990.[89]

The requirement of all churches to file the Form 990-N, even as bare as the form currently is, provides a better alternative to the complete lack of annual reporting.[90] It would put the IRS on notice of the mere existence of some organizations claiming to be churches.[91] If expanded to include relevant financial information, it would also help prevent future occurrences of tax fraud and financial misconduct through the necessity of responsible accounting and the resulting ethics standards required of financial and legal professionals.[92] Furthermore, requiring much of the same information from churches as other nonprofit organizations would place almost all nonprofit, charitable, and religious organizations on virtually equal footing regarding IRS treatment.[93] In effect, this should eliminate concerns of "excessive entanglement."[94]

IV. PROHIBITION AGAINST PRIVATE INUREMENT

Perhaps one of the cloudiest areas of existing law regarding tax-exempt organizations is that of the prohibition against private inurement.[95] Section 501(c)(3) contains the requirement that, "no part of the net earnings . . . inures to the benefit of any private shareholder or individual," alongside the "organized and operated" requirements.[96] The prohibition against inurement is

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89. *Cf.* Information Reported on Form 990-N, *supra* note 86, *with* Return of Organization Exempt From Income Tax (OMB No. 1545-0047) (2012), *available at* http://www.irs.gov/pub/irs-pdf/f990.pdf.

90. *See* Information Needed to File e-postcard, *supra* note 87.

91. *See* Grassley Memorandum, *supra* note 10, at 20.

92. *See* Grassley Memorandum, *supra* note 10, at 28 (citing Tax-Exemption Hearings, supra note 82, at 162 (in which Oral Roberts' testimony suggesting that if Jim Bakker's organization was required to file the annual Form 990, the fraudulent activities would not have taken place)).

93. *See* I.R.C. § 6033(a)(1) (2012).

94. *See* Grassley Memorandum, *supra* note 10, at 26.

95. Darryll K. Jones, *The Scintilla of Individual Profit: In Search of Private Inurement and Excess Benefit*, 19 VA. TAX REV. 575, 578-81 (2000). The word "inurement" is left undefined by the Code and its regulations, and the courts and the IRS find it unnecessary to place a special meaning to the term. *See* I.R.S., *C. Overview of Inurement/Private Benefit Issues in IRC 501(c)(3)* (1990), *available at* http://www.irs.gov/pub/irs-tege/eotopicc90.pdf. They have focused on the word "private" in determining whether a benefitting individual is disallowed to receive benefits disproportionate to his services to the organization. *See id.* at 2-3. For purposes of this analysis and the issues it addresses, however, we will assume that the beneficiary of any alleged inurement is a "private" person or persons as stated in section 501(c)(3). *See* Presbyterian and Reformed Publ'g Co. v. Comm'r, 743 F.2d 148, 153 (3rd Cir. 1984) (citing Treas. Reg. § 1.501(a)-1(c) (1982)).

96. I.R.C. § 501(c)(3).

found again within the regulation's operational test.[97] "The prohibition is designed to prevent the conversion of a tax-exempt endeavor into a personal wealth-creating endeavor."[98] Although compensation is allowable to church officers, directors, trustees, employees, and independent contractors,[99] compensation in excess of the services provided constitutes inurement.[100]

But distributions other than those of excessive salaries may also be considered inurement.[101] Whatever the form of the channeling of net earnings, the statutory language mandating that "no part of the net earnings . . . inures" is unqualified and absolute.[102] As stated by the court in *Founding Church*, "the amount or extent of benefit should not be the determining factor."[103]

A. *The Lack of Guidelines*

Again, the finding of inurement is a finding of fact.[104] Because each court has considerable discretion in making its findings of fact, the analyses courts utilize when evaluating whether private inurement has occurred are necessarily fact-intensive, and courts have so far failed to articulate a clear standard.[105] While this may be frustrating for one looking for a well-defined rule, the lack of such a definite rule allows for flexibility in the choice of fact-finding method to fit the situation. For example, when the organization concealed records from the Tax Court in *Church of Scientology*[106], the court recognized two types of indicia that inurement occurred, overt and covert, and analyzed each respectively.[107] The Tax Court in this case also

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97. Treas. Reg. § 1.501(c)(3)-1(c)(2) (2008).

98. Jones, *supra* note 95, at 582.

99. Founding Church of Scientology v. United States, 188 Ct. Cl. 490, 496 (1969).

100. Church of Scientology of Cal. v. Comm'r, 83 T.C. 380, 492 (1984).

101. *See Founding Church*, 188 Ct. Cl. at 496-99 (finding that inurement occurred where Scientology organizations paid founder 10% of their gross income).

102. I.R.C. § 501(c)(3) (2012); *Church of Scientology*, 823 F.2d at 1316 (citing *Founding Church*, 188 Ct. Cl. at 500).

103. *Founding Church*, 188 Ct. Cl. at 500 (citing Spokane Motorcycle Club v. United States, 222 F. Supp. 151 (E.D. Wash. 1963)).

104. *See id.*

105. Jones, *supra* note 95, at 592.

106. *See generally* Church of Scientology v. Comm'r, 83 T.C. 381 (1984), *aff'd*, 823 F.2d 1310, 1313.

107. *Id.* Overt indicia included "living expenses, and from salaries and royalties" received by the church's leader, L. Ron Hubbard. *Id.* at 495. The court said the combined value of these payments "prove[d] conclusively" that inurement occurred. *Id.* An example of a covert indicium in this case was compensation paid by Scientology organizations to Mr. Hubbard and characterized as "Founding Debt Payments," for which there was not much documentation. *Id.* The court in an unrelated suit concluded that these payments

demonstrated that it may consider the language and phrasing of the organization's internal documents when considering whether its purpose was truly exempt, or if it was operated for a substantially non-exempt purpose.[108]

On the other hand, the lack of an articulable legal standard leaves much to be desired in academia, as well as for counsel attempting to soundly advise a tax-exempt organization.[109] Even Judge Posner exhibited frustration when, in oral argument, counsel responded with the "facts and circumstances" analysis to the question regarding what standard the court should use as a guide to a decision in this area.[110] Judge Posner declared it "no standard at all."[111] However, it is the standard that the Internal Revenue Service has relied upon for decades.[112]

This standard leaves wide open the number of ways courts may apply the law to circumstances that should deserve a theoretical standard of analysis instead of a mere review of the case's "facts and circumstances."[113] For example, compensation calculated as a percentage of revenue generated by a performer's services for a tax-exempt entity can be considered either excessive or reasonable, depending on the decision-maker's definition of "net earnings."[114] Such definition must be grounded in the perceived legal relationship between the performer and the entity, for which there may be varying conclusions.[115]

The rule prohibiting private inurement is an "elusive, elastic, and evolving theory rather than a safely articulated standard."[116] And once a court finds that private inurement has occurred, the corresponding penalty is revocation of the

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"suggest[ed] a franchise network for private profit" and found inurement to have occurred. Founding Church of Scientology v. United States, 188 Ct. Cl. 490, 498 (1969).

108. *See Church of Scientology*, 83 T.C. at 422-23 (noting the organization's Governing Enumerated Policy of Finance contained "MAKE MONEY," "MAKE MORE MONEY," and "MAKE OTHER PEOPLE PRODUCE SO AS TO MAKE MONEY" as its objectives; also recognizing that the organization "often used business terminology to describe its operations").

109. *See generally* Jones, *supra* note 95, at 593-95 (attempting to categorize and clearly define three different types of inurement: "strict accounting private inurement," "incorporated pocketbook private inurement," and "joint venture private inurement").

110. United Cancer Council, Inc. v. Comm'r, 165 F.3d 1173, 1179 (7th Cir. 1999).

111. *Id.* at 1179.

112. Jones, *supra* note 95, at 591-92 n.60.

113. *See, e.g., Church of Scientology*, 83 T.C. at 422-23, 495 (examining internal documents, as well as categorizing two types of indicia that inurement occurred); Church in Bos. v. Comm'r, 71 T.C. 102 (1978) (examining the percentages of receipts that were granted to officers).

114. Jones, *supra* note 95, at 581-84.

115. *Id.*

116. *Id.* at 580-81.

organization's tax-exempt status.[117] Because of the harshness of this punishment, the IRS now rarely invokes the claim that private inurement has occurred, and instead pursues sanctions for excess benefit transactions.[118] Thus, neither the Commission Report nor the Grassley Memorandum discusses the bewildering state of the law regarding private inurement.[119]

B. *Forming Guidelines*

Although the Commission Report and Grassley Memorandum ignore the law prohibiting private inurement, likely because it is so rarely utilized, some clarity is needed in the Code and Treasury Regulations for determining if private inurement has occurred.[120] The prohibition on private inurement is written into the statute as one of the requirements for an organization to be considered tax-exempt, alongside the requirement that it be "organized and operated exclusively for religious . . . purposes."[121] Therefore, the prohibition on private inurement also exists *outside* of the operational test, in addition to *inside* the Treasury-interpreted test.[122] As previously noted, whether the operational test is met is a question of fact;[123] but the Treasury can spell out specific guidelines for courts to determine whether private inurement occurs, without disturbing the other functions of the Code or Regulations.[124] One problem in forming such guidelines is the risk that the guideline would be overly precise, as there are many forms of private inurement of which to be aware but aren't specified by courts, statute, or regulations.[125]

It would benefit this discussion to mention that Professor Darryll K. Jones has attempted to organize the different types of private inurement into three categories: 1) "strict accounting private inurement"; 2) "incorporated pocketbook private inurement"; and 3) "joint venture private inurement."[126] Although courts do not explicitly mention these categories, they

117. *See* Treas. Reg. § 1.501(c)(3)-1(a)(1) (2008).

118. Grassley Memorandum, *supra* note 10, at 57. *See* discussion *infra* Parts V-VI.

119. *See generally* Commission Report, *supra* note 25; Grassley Memorandum, *supra* note 10.

120. *See* I.R.C. § 501(c)(3) (2012); Treas. Reg. § 1.501(c)(3)-1.

121. I.R.C. § 501(c)(3).

122. *See id.*; Treas. Reg. § 1.501(c)(3)-1(c)(2).

123. Church by Mail, Inc. v. Comm'r, 765 F.2d 1387, 1390 (9th Cir. 1985) at 1390.

124. *See e.g.* Treas. Reg. § 1.501(c)(3)-1(c)(2); *See generally* I.R.C. § 501(c)(3).

125. *See* Jones, *supra* note 95, at 594-95, 610-12, 620-22. .

126. See *id.* at 594-95, 610-12, 620-22.

are helpful in forming guidelines to determine whether private inurement is present.[127]

Strict accounting private inurement occurs where "an insider [i.e., one who possesses "ownership-like authority"[128] within the organization] realizes an accession to wealth greater than the value of goods or services provided to the entity."[129] The concept itself appears clear, but an issue could easily arise regarding the valuation of the services provided to the entity. For this issue, regulations could consider as evidence the compensation provided for similar services rendered to similarly situated nonprofit organizations.

Incorporated pocketbook private inurement, according to Professor Jones, occurs during "transactions [that] have little, if any, positive effect on an exempt organization's ostensible beneficiaries but result in some value to an insider, regardless of whether the insider provides equal value to the entity."[130] To illustrate this category, Jones gives the example of a President and Vice President of a tax-exempt educational organization using their power to earn a low salary, but to travel overseas on the organization's account and allocate its own tuition funds for relatives—all while providing little benefit to the organization's purported beneficiaries.[131] Although the insider would not in the aggregate be receiving in excess of his or her services, the finding of private inurement can still occur.[132] To borrow language from Jones, a Treasury Regulation may consider whether "the insider is exercising his right of control in a manner [that] renders the entity's wealth synonymous with his own regardless of whether the total amount is less than what would be a reasonable salary," and whether the transaction provides little to the organization's purported beneficiaries.[133]

Joint venture private inurement can occur when "the operations of the tax-exempt entity and an insider-controlled taxable entity are so closely related that the insider, by virtue of his interest in the taxable entity, financially benefits from the exempt entity's invariable consumer power," even though the

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127. *Id.* at 594-95.

128. *Id.* at 577.

129. *Id.* at 595.

130. *Id.* at 611.

131. *Id.* at 611-13.

132. *Id.* at 613 (citing Labrenz Found., Inc. v. Comm'r, 33 T.C.M. (CCH) 1374, 1379 (1974) (stating that just because withdrawals may not exceed value of services provided does not prevent a finding of private inurement)).

133. See *id.* at 613.

organization is actively serving a legitimately exempt purpose.[134] To identify when this type of inurement occurs, Jones relies on general tax law, which considers four factors when determining if a joint venture exists: 1) an express or implied agreement indicating intent to establish a business venture; 2) joint control and proprietorship; 3) contributions from each party of some asset to the venture; and 4) a sharing of profits.[135]

In summation, the following questions may be asked regarding a person within the organization, to which an affirmative answer would yield a finding of private inurement:

> 1) Is the insider realizing an accession to wealth greater than the value of goods or services that he or she is providing to the entity?[136]
> 2) Is the insider exercising his right of control in a manner that renders the entity's wealth synonymous with his own regardless of whether the total amount is less than what would be a reasonable salary, and is such exercise providing insubstantial benefit to the organization's purported beneficiaries?[137]
> 3) Does a relationship between a tax-exempt entity and a business entity contain the elements of a joint venture, as determined using general tax principles?[138]

By developing regulations that mirror these concepts and questions, the Treasury may provide some clarity to the area of private inurement.

V. EXCESS BENEFIT TRANSACTIONS

A. *Generally*

In 1996, Congress enacted section 4958 of the Internal Revenue Code, which imposes two tiers of excise taxes on "excess benefit transactions."[139] Put simply, an excess benefit transaction is a transaction in which an "applicable tax-exempt

134. *Id.* at 621-23.
135. *See id.* at 623 (citing Podell v. Comm'r, 55 T.C. 429, 431 (1970)).
136. *See id.* at 595.
137. *Id.* at 613.
138. *Id.* at 623.
139. I.R.C. § 4958(a)-(c) (2012).

organization"[140] compensates a "disqualified person" an amount that exceeds the value of services provided for such compensation.[141] Included in the definition of a "disqualified person" are, *inter alia*, (1) persons that were in a position to exercise substantial influence over the organization's affairs within a five-year period ending on the date of the transaction, (2) members of that's person's family,[142] and (3) any entity of which those defined in (1) or (2) own more than 35% of the voting power.[143]

The first tier of taxes, the "initial taxes," consist of the imposition on the disqualified person of a 25% tax on the excess benefit,[144] and a 10% tax on the participating organization manager[145] if he or she participates "knowing" it is an excess benefit transaction.[146] The second tier is the imposition of an "additional tax," whereby the disqualified person is taxed at 200% of the excess benefit if the transaction "is not corrected within the taxable period."[147]

The excise taxes on excess benefit transactions are not to be mistaken as a mere substitute for status revocation, as Treasury Regulations make clear.[148] Indeed, there are some situations in which an excess benefit transaction could occur without the presence of private inurement, and vice versa.[149] For those situations, the prescribed penalties of excess benefit transactions

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140. I.R.C. § 4958(e)(1). For purposes of this comment, a church qualifies as an "applicable tax-exempt organization." *See id.* (including organizations described in I.R.C. § 501(c)(3) in the definition of "applicable tax-exempt organization").

141. *See* I.R.C. § 4958(c)(1)(A) (defining an "excess benefit transaction" as a transaction in which "an economic benefit is provided by an applicable tax-exempt organization directly or indirectly to or for the use of any disqualified person if the value of the economic benefit provided exceeds the value of the consideration (including the performance of services) received for providing such benefit").

142. I.R.C. § 4958(f)(4). "Family members" are as follows: spouse; ancestors; children; grandchildren; great grandchildren; the spouses of children, grandchildren, and great grandchildren; whole- and half-blood brothers and sisters; and the spouses of those brothers and sisters. *Id.* (referencing I.R.C. § 4946(d)).

143. I.R.C. § 4958(f)(1), (3).

144. Treas. Reg. § 53.4958-1(b) (2002). "An excess benefit is the amount by which the value of the economic benefit provided by an applicable tax-exempt organization directly or indirectly to or for the use of any disqualified person exceeds the value of the consideration (including the performance of services) received for providing such benefit." *Id.*

145. Treas. Reg. § 53.4958-1(d)(2)(i). An organization manager is "any officer, director, or trustee of such organization" or an individual with similar powers, whether specifically designated or merely regularly exercised. *Id.*

146. I.R.C. § 4958(a).

147. *Id.* § 4958(b).

148. Treas. Reg. § 53.4958-8 (2002) (stating that "[s]ection 4958 does not affect the substantive standards for tax exemption under section 501(c)(3)").

149. Jones, *supra* note 95, at 586-88.

and private inurement appear to be complementary: The result of an excess benefit transaction is the imposition of excise taxes on both the person and on the organization's management if he or she knowingly participated, while the result of private inurement is the revocation of the tax exempt status.[150] However, any excess benefit transaction would likely violate the prohibition on private inurement,[151] and most instances of private inurement would also be considered violations of section 4958.[152] The practical result is the availability of the excess benefit transaction provision as an "intermediate" penalty,[153] and this seems to be in accordance with legislative intent.[154] The excise taxes on excess benefit transactions are seen as a "less draconian alternative" to the "harsh" penalty of status revocation for private inurement where both violations occur within the same transaction.[155]

B. *Determining Reasonable Compensation*

One provision with which the Grassley Memorandum takes issue is the presence of the rebuttable presumption of reasonableness that is applied to compensation agreements and property transfers between disqualified persons and the organization.[156] Treasury Regulations state that, for the presumption of reasonable compensation to apply, three requirements need to be met: (1) the agreement or transfer is "approved in advance by an authorized body of the applicable tax-exempt organization"; (2) "[t]he authorized body obtained and relied upon appropriate data as to comparability prior to making its determination"; and (3) such body "adequately documented the basis for its determination."[157] Once those requirements are satisfied, the Commissioner may rebut the presumption "only if

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150. *Cf.* I.R.C. § 4958(a) (2012) (imposing excise taxes on the "disqualified person" and on "the management" of an excess benefit transaction), *with* Treas. Reg. § 1.501(c)(3)-1(a)(1) (2008) (stating that if an organization fails to meet the operational test, in which the prohibition against inurement may be found, it is not exempt).

151. David A. Levitt, *Excess Benefit Transactions Under 4958 and Revocation of Tax-Exempt Status*, 23 NO. 3 PRAC. TAX LAW. 13, 15 (2009).

152. T.D. 8978, 2002-53 C.B. 3082 (2002).

153. Jill S. Manny, *Nonprofit Payments to Insiders and Outsiders: Is the Sky the Limit?*, 76 FORDHAM L. REV. 735, 736 (2007).

154. *See* H.R. REP. NO. 104-506, at 59 (1996) ("[I]ntermediate sanctions . . . may be imposed . . . in lieu of, or in addition to, revocation of an organization's tax-exempt status").

155. Manny, *supra* note 153, at 750-52; *see also* Levitt, *supra* note 151, at 14; *The Inurement Prohibition & Non-Profit Organizations*, NONPROFIT LAW REPORT, http://www.nonprofitlawreport.com/guide/private-inurement.

156. Grassley Memorandum, *supra* note 10, at 40-42.

157. Treas. Reg. § 53.4958-6(a) (2002).

[he or she] develops sufficient contrary evidence to rebut the probative value of the comparability data relied upon by the authorized body."[158] But the failure to qualify for the presumption does not result in any inference that an excess benefit transaction has occurred.[159]

One of the underlying problems with the rebuttable presumption is the type of comparability data that an organization may use to determine reasonable compensation.[160] Regulations list several factors to be considered when the organization determines reasonable compensation:

> [1] compensation levels paid by similarly situated organizations, both taxable and tax-exempt, for functionally comparable positions; [2] the availability of similar services in the geographic area of the applicable tax-exempt organization; [3] current compensation surveys compiled by independent firms; and [4] actual written offers from similar institutions competing for the services of the disqualified person.[161]

Although the factors are not limited to this list,[162] it is particularly troubling that, of the four listed in the Treasury Regulations, the first factor is allowed to depend on potentially deceptive statistics, especially when applied to churches, as the following discussion intends to show.[163]

The only limitation provided by the first factor is that the information regard "similarly situated organizations."[164] The Grassley Memorandum gives an example of a study prepared for one of the six investigated churches conducted by a "leading compensation consulting firm," which concluded that the minister should be compensated $2 million.[165] The firm argued that, because the "high" compensation provided by churches having 1,000 members and an $800,000 annual budget is $236,000, then the minister of the client-church should be ten times that amount due in part to the televangelist's reaching

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158. Treas. Reg. § 53.4958-6(b).

159. Treas. Reg. § 53.4958-6(e).

160. *See* Treas. Reg. § 53.4958-6(c)(2).

161. *Id.*

162. *Id.*

163. *See generally id.* (discussing "in the case of compensation, relevant information includes, but is not limited to, compensation levels paid by similarly situated organizations, both taxable and tax-exempt, for functionally comparable positions").

164. *See id.*

165. Grassley Memorandum, *supra* note 10, at 43-44.

between 5 million and 15 million people through media.[166] This reasoning could be extended to situations on an infinitely grand scale, and the speed at which information may be transmitted renders as wild speculation the count of how many people the minister has "reached." Without more, this factor is reduced to mere rhetoric disguised as a key component of a Treasury Regulation.[167]

There is yet another glaring problem with the first factor in the above regulation: by allowing a church's consideration of the amount paid by taxable organizations, it allows the organization determining compensation consider the salaries of executives of for-profit corporations.[168] If an organization wishes to pay an excessive amount to a disqualified person, this detail only aids the organization in determining the "reasonable compensation" to be an absurdly high amount.

In fact, the Commission Report cedes that the limitation of comparability data exclusively to the nonprofit sector is a viable alternative, but it states that the alternative should be implemented only if "valid empirical data" shows improper use of non-comparable data from the for-profit sector.[169] And, assuming this modification was made, the Commission Report advocates for the nonprofits' continued use of comparability data from the for-profit sector, albeit without the presumption of reasonableness.[170] The report argues for this precondition while citing a recent survey showing that "only 4% of organizations surveyed use data from the for-profit sector in setting executive compensation."[171] The argument that "the use of an unjustifiable discretion is not widespread" is not an excuse to neglect a feasible alternative—an alternative that would not otherwise harm or burden the organizations that are not currently abusing such discretion.[172]

The Grassley Memorandum advocates for the development of "guidelines for compensation studies, including when a comparison to for-profit organization is appropriate, and

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166. *Id.* at 43-44. The study even took into consideration "the compensation of for-profit CEOs and media personalities like Oprah Winfrey, Britney Spears, Madonna, Rosie O'Donnell, and David Letterman." *Id.* at 44.

167. *See generally* Treas. Reg. § 53.4958-6(c)(2) (2002).

168. *See id.*

169. Commission Report, *supra* note 25, at 15.

170. *Id.*

171. *Id.* at 16 (citing BOARDSOURCE, RESEARCH BRIEF: RESULTS OF THE 2012 NONPROFIT EXECUTIVE COMPENSATION SURVEY 2-3 (2012), *available at* www.boardsource.org/dl.asp?document_id=1304).

172. Id. at 15.

requiring public disclosure of the studies and data used to determine compensation."[173] Instead of heeding this vague and toothless approach, the Treasury could instead draw a bolder line regarding the types of comparability data allowable when determining a reasonable compensation. Virtually no standards would exist to determine the reasonableness of compensation if comparability data was not considered, so such data is needed.[174] But allowing churches and independent firms to determine this based solely on "similarly situated" for-profit organizations is absurd.[175] A combination of two actions may be taken: 1) eliminate the consideration of compensation provided by taxable organizations from the current regulation; and 2) in lieu of the surveys compiled by independent firms, prescribe guidelines for reasonable compensation, including numerical recommendations.

As discussed earlier, the first action is feasible and fair, as circuitously admitted by the Commission Report.[176] The second action would require the Treasury or a similarly situated entity to compile data determining reasonable compensation ranges for churches in each region, state, or other measure of geographic territory. In making such determinations, that entity could consider various factors, including church revenue, monthly attendance, geographical location, and the standard of living of the area in which the church is established. This data could then be used in setting reasonable salary ranges within which the parties could safely enjoy the presumption of reasonableness.

This two-pronged approach would eliminate the highest salaries from compensation consideration and, at the same time, give the IRS and courts a more definite value off which to base their decisions should the transactional parties be called to task.[177]

C. *The "Knowing" Standard*

As previously discussed, the Code imposes an excise tax on both the disqualified person and the participating organization manager, but on the latter only if he or she participated "knowingly."[178] The Grassley Memorandum takes issue with the requirement that the organization manager participates in the excess benefit transaction while "knowing" that it is such a

173. Grassley Memorandum, *supra* note 10, at 44.
174. *See generally* Treas. Reg. § 53.4958-6 (2002).
175. *See* Treas. Reg. § 53.4958-6(c)(2).
176. *See* Commission Report, *supra* note 25, at 15.
177. *See generally* Treas. Reg. § 53.4958-6(c)(2).
178. I.R.C. § 4958(a) (2012).

transaction in order for the initial excise tax to apply to the manager.[179] A manager participates in an excess benefit transaction "knowingly" if the person

> (A) Has actual knowledge of sufficient facts so that, based solely upon those facts, such transaction would be an excess benefit transaction;
> (B) Is aware that such a transaction under these circumstances may violate the provisions of Federal tax law governing excess benefit transactions; and
> (C) Negligently fails to make reasonable attempts to ascertain whether the transaction is an excess benefit transaction, or the manager is in fact aware that it is such a transaction.[180]

Although "[k]nowing does not mean having reason to know," evidence that the manager had reason to know of a particular fact or rule is relevant in determining whether actual knowledge existed.[181] The "knowing" standard is ordinarily not reached if the manager relies on a "reasoned written opinion of [a] professional with respect to elements of the transaction within the professional's expertise," after a full disclosure of the factual situation.[182] But the absence of such an opinion does not "give rise to any inference" of knowledge.[183] Finally, the Commissioner bears the burden of proof in cases in which the determination of whether an excess benefit transaction has occurred is at issue.[184]

The Grassley Memorandum makes the argument that the standard "provides extensive escape routes" and "create[s] an incentive for managers to remain ignorant."[185] Therefore, it advocates, a "reason to know" standard should be adopted.[186] It references the presence of the proposed standard in section 4965, which imposes a $20,000 tax on a tax-exempt entity's manager if he or she approves the entity as a party to a prohibited tax shelter transaction and "knows or has reason to know" that it is such a transaction.[187]

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179. *See* Grassley Memorandum, *supra* note 10, at 37-39.
180. Treas. Reg. § 53.4958-1(d)(4)(i) (2002).
181. Treas. Reg. § 53.4958-1(d)(4)(ii).
182. Treas. Reg. § 53.4958-1(d)(4)(iii) (as amended Jan. 2009).
183. *Id.*
184. Treas. Reg. § 53.4958-1(d)(9).
185. Grassley Memorandum, *supra* note 10, at 38-39.
186. *Id.* at 39.
187. *Id.* at 39 (referencing I.R.C. § 4965(a)(2), (b)(2) (2012)).

The Commission Report counters that such a change in the Code would repel highly qualified, independent board candidates and encourage organizations to seek the services of non-independent board members.[188] However, although "the roles of directors of nonprofit institutions are more demanding and complex than those of their for-profit peers . . . almost all evidence suggests that nonprofit directors provide less oversight, less effective participation in decision-making, and in general, less effective governance than their peers in comparable for-profit corporations."[189] The adoption of the "reason to know" standard could impact nonprofit organizations in several ways, which include renewing the demand for more attentiveness from the directors of those organizations, as well as narrowing the loopholes for methods by which an ill-intending director may operate to benefit a disqualified person[190] As Professor Jill S. Manny points out, while an argument may be made that this may deter some highly qualified professionals from serving as directors because of the increased possibility of excise tax liability, this outcome "should be viewed as a positive result."[191] The optimism is based on the argument's veiled premise that those professionals would either a) predict that he or she would be inattentive, or b) have ulterior motives to becoming a director.[192] A system that discourages financial and operational inattentiveness is societally desirable, whether the penalties for such inattentiveness are reflexively imposed in the private sector or government-imposed in the nonprofit realm.[193]

D. *Conclusion*

Currently, a church's authorized body may rely on biased conclusions in its determination of compensation for a disqualified person.[194] Such information may help form the basis for the rebuttable presumption that automatically applies once the other two easily attainable requirements are met.[195] Additionally, in order for any one organization manager to be hit with an excise tax, the Commissioner must prove that the

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188. Commission Report, *supra* note 25, at 17.

189. Manny, *supra* note 153, at 756 (quoting Harvey J. Goldschmid, *The Fiduciary Duties of Nonprofit Directors and Officers: Paradoxes, Problems, and Proposed Reforms*, 23 J. CORP. L. 631, 632 (1998)).

190. *See* Manny, *supra* note 153.

191. *See id.*

192. *See id.* at 757.

193. *See id.* at 750-53.

194. *See* Treas. Reg. § 53.4958-6(c)(2) (2002).

195. *See* Treas. Reg. § 53.4958-6(b).

manager engaged in the transaction "knowing" that it was an excess benefit transaction and that it may have violated the tax law.[196] Each one of these flaws in the Code and regulations acts as an entire buffer against potential tax liability.[197]

If the provision imposing excise taxes on excess benefit transactions is to be effectively enforced, major overhaul of the corresponding regulations is needed.[198] However, reforms of the regulatory issues discussed above need to occur simultaneously in order to have any real effect.[199]

VI. CHURCH TAX INQUIRY

Section 7611 of the Internal Revenue Code (introduced as legislation in 1970 by Senator Grassley) carves out a special exception for churches regarding IRS enforcement: higher procedural requirements need to be met before the IRS can conduct a "church tax inquiry."[200] The provision allows for a church tax inquiry only if (1) "an appropriate high-level Treasury official reasonably believes (on the basis of facts and circumstances recorded in writing) that the church" may not be operating within the requirements of the tax-exempt status of a church or carrying on an unrelated trade or business that is subject to tax; and (2) the IRS provides the church with notice of such inquiry.[201]

A church tax inquiry is any inquiry that is aimed at determining whether a church is operating within its exempt status.[202] As the Grassley Memorandum points out, the Joint Committee on Taxation realized that many taxpayers were utilizing churches as tax avoidance devices, and they explained that simple inquiries and examinations may be made without constituting a section 7611 inquiry.[203] While this may permit the IRS to enforce the prohibition on private inurement, Treasury Regulations dictate that the above requirements need to be met

196. *See* Treas. Reg. § 53.4958-1(d)(4)(i) (2002).

197. *See generally* Treas. Reg. § 53.4958-6(c)(2), -6(b), -1(d)(4)(i).

198. *See generally* I.R.C. § 4958 (2012); Treas. Reg. § 53.4958-1, -6.

199. *See also* Grassley Memorandum, *supra* note 10, at 42, 44. *See generally* Treas. Reg. § 53.4958-1; Treas. Reg. § 53.4958-6.

200. I.R.C. § 7611(a).

201. *Id.*

202. I.R.C. § 7611(h)(2).

203. Grassley Memorandum, *supra* note 10, at 34-35 (citing STAFF OF J. COMM. ON TAXATION, 98TH CONG., GENERAL EXPLANATION OF THE REVENUE PROVISIONS OF THE DEFICIT REDUCTION ACT OF 1984, 1140 (J. Comm. Print 1985)).

to conduct an inquiry for the purposes of determining if an excess benefit transaction has occurred.[204]

The problem with this standard is apparent. Taken together with the church's exception from the requirements of application for tax-exempt status and annual reporting, both section 7611 and Treas. Reg. § 53.4958-1(b) make it increasingly difficult for the IRS to enforce provision regarding excess benefit transactions, among other potential breaches of the Code.[205] Vital documentation usually provided by the application and annual returns would be lacking, and this is especially important when the IRS needs facts and circumstances "recorded in writing."[206]

The regulatory provision imposing the "church tax inquiry" requirements should be eliminated in its entirety. The original force of section 7611 has been weakened by congressional explanation.[207] The regulatory tie-in should not be more imposing than the statute itself, especially when it impedes the IRS' ability to enforce the Code while offering no apparent benefit to anyone.[208]

As a counterpoint, the Commission Report notes Senator Grassley's statement that "the law was 'drafted to be certain churches are protected from unfounded examinations,'"[209] as the absence of this protection would result in "excessive entanglement" concerns.[210] However, this point assumes an erroneous logical leap that the elimination of these procedural requirements would result in unfounded examinations.[211] Instead, the repeal of section 7611 would mean only that churches would be subject to the same amount of scrutiny as other nonprofit organizations, as they were pre-1970—no more and no less.[212]

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204. Treas. Reg. § 53.4958-1(b).

205. *See generally* I.R.C. §§ 508(a)(1), (c)(1)(A), 6033(a)(1), (3)(A)(i), 7611; Treas. Reg. § 53.4958-1(b).

206. *See* I.R.C. § 7611(a)(2) (2012).

207. *See* STAFF OF J. COMM. ON TAXATION, 98TH CONG., GENERAL EXPLANATION OF THE REVENUE PROVISIONS OF THE DEFICIT REDUCTION ACT OF 1984, 1140 (J. Comm. Print 1985).

208. *See generally* I.R.C. § 7611; Treas. Reg. § 53.4958-1(b).

209. Commission Report, *supra* note 25, at 46 (quoting 130 CONG. REC. 9152 (Apr. 12, 1984) (statement of Sen. Charles Grassley)).

210. *Id.* at 46.

211. *See generally id.* at 46.

212. *See* I.R.C. § 7611.

VII. PARSONAGE

The topic of parsonage offers more interesting substance in the way of case law and history than the subjects discussed above. It is important to note the intricacies of this topic, as they provide valuable insight into the courts' perspectives on the law regarding tax exemption.

A. *Section 107*

The Internal Revenue Code provides that a "minister of the gospel" may receive housing from that minister's church, and the value of that housing may be excluded from the minister's gross income, the amount of which is commonly referred to as "parsonage."[213] Treasury Regulations limit the persons who qualify for this exclusion to those who are "duly ordained, commissioned, or licensed minister[s] of a church" or members of a religious order.[214] The Internal Revenue Code Section 107 provides two alternative methods by which the minister may receive such housing benefits: (1) a home furnished to him as part of his compensation or (2) "rental allowance" paid to him as part of his compensation.[215]

B. *Limitations on Amount Excludable*

The Code limits the amount excludable under section 107(2), which allows for "rental allowance" as parsonage, to the allowance "used by him to rent or provide a home and to the extent such allowance does not exceed the fair rental value of the home, including furnishings and appurtenances such as a garage, plus the cost of utilities."[216] According to Treasury Regulations, the allowance falls under section 107(2) if it is used (1) to rent a home, (2) to purchase a home, and (3) for expenses directly related to providing a home.[217] Any amount exceeding this use

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213. I.R.C. § 107.

214. Treas. Reg. § 1.107-1(a) (1963) (specifying that the rules in Treas. Reg. § 1.1402(c)-5 (1968), which designate these qualifications, apply in making the determination of whether a taxpayer received rental allowance as remuneration for services that are ordinarily the duties of a minister). Although the phrase "minister of the gospel" generally refers to those who preach the teachings of Christ in the Holy Bible's New Testament, the term applies to "persons holding an equivalent status in other religions." Silverman v. Comm'r, No. 72-1336, 1973 WL 2493, at *3 (8th Cir. July 11, 1973), *acq.*, 1978-2 C.B. 2 (citing Salkov v. Comm'r, 46 T.C. 190 (1966), *acq.*, 1978-2 C.B. 2).

215. I.R.C. § 107(1)-(2).

216. I.R.C. § 107(2).

217. Treas. Reg. § 1.107-1(c). In Warren v. Comm'r, 114 T.C. 343, 345 & n.1 (2000), expenses for "providing a home" included "expenses for mortgage, utilities, furnishings,

must be included in his gross income.[218] In a brief revenue ruling that addresses whether a minister performing "occasional and insignificant services" may exclude a parsonage allowance from gross income, the Internal Revenue Service made clear that the exclusion is limited to the amount considered to be "reasonable compensation" for the minister's services.[219]

Although these rules may be quite definitive in theory, they are quite difficult to enforce in practice for two aforementioned reasons: 1) the church exemption from annual filing requirements;[220] and 2) the heightened procedural standard the IRS must satisfy before initiating a "church inquiry" to investigate the possibility that an excess benefit transaction occurred.[221]

Firstly, because the church does not report this transaction and the minister is permitted to exclude the allowance from gross income, the Internal Revenue Service "has no means of judging whether the expense payment is reasonable."[222] The lack of reporting also leaves the IRS in the dark as to how the allowance is actually spent.[223] Secondly, because Treasury Regulations are bound to the heightened procedural standard for initiating a church inquiry regarding a possible excess benefit transaction,[224] the IRS' broad discretion to conduct inquiries and issue summonses is eliminated.[225] Thus, the standard effectively

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landscaping, repairs, and maintenance and real property taxes and homeowner's insurance premiums," as stipulated by the parties.

218. Treas. Reg. § 1.107-1(c) (excepting food and servants, as well as rental allowance expended in connection with farm or business property, from the § 107 gross income exclusion).

219. Rev. Rul. 78-448, 1978-2 C.B. 105.

220. I.R.C. § 6033(a)(3)(A)(i). *See also* Matthew W. Foster, Note, *The Parsonage Allowance Exclusion: Past, Present, and Future*, 44 VAND. L. REV. 149, 158 n.76 (1991).

221. Treas. Reg. § 53.4958-8(b) (2002) (stating that the procedures of I.R.C. § 7611 will be used in "initiating and conducting any inquiry or examination into whether an excess benefit transaction has occurred" between a church and minister). An "excess benefit transaction" is defined in I.R.C. § 4958, which also imposes an excise tax of 25% on the excess benefit for a person who received such excess benefit from a church.

222. Foster, *supra* note 10, at 158 n.76 (quoting MARTIN A. LARSON & C. STANLEY LOWELL, THE RELIGIOUS EMPIRE: THE GROWTH AND DANGER OF TAX-EXEMPT PROPERTY IN THE UNITED STATES 22 (1976)).

223. *See id.* (quoting MARTIN A. LARSON & C. STANLEY LOWELL, THE RELIGIOUS EMPIRE: THE GROWTH AND DANGER OF TAX-EXEMPT PROPERTY IN THE UNITED STATES 22 (1976)).

224. I.R.C. § 7611(a)(2) (2012).

225. *Id. Compare* I.R.C. §§ 7601-02 (granting the IRS broad authority to "canvass" each district for tax liability, examine relevant records, issue appropriate summonses, and take testimony, with few restrictions), *with* I.R.C. § 7611(a)(2) (requiring "an appropriate high-level Treasury official" to have "reasonable belief" that an excess benefit transaction occurred "on the basis of facts and circumstances recorded in writing" before the IRS may initiate an inquiry regarding the occurrence of an excess benefit transaction).

hampers the IRS' ability to investigate the possible occurrences of excess parsonage allowances.[226]

C. *Designation*

Treasury Regulations provide that the parsonage allowance must be designated by the minister's church.[227] In *Warnke v. United States*,[228] a district court explains that this rule is the logical result of congressional intent.[229] "[T]o allow a § 107(2) minister to designate his own 'rental allowance' would place him in a more favorable position than a minister who is limited to the 'rental value' of the home chosen for him by his church."[230] The designation requirement, therefore, "eliminates the disparity between Section 107(1) ministers and Section 107(2) ministers."[231] Additionally, the rule is "consistent with the intent that the allowance exclusion amount be readily ascertainable."[232]

D. *Number of Excludable Homes*

The Grassley Memorandum discusses the issue of whether "the parsonage allowance [should] be limited to a single primary residence or to a specific dollar amount."[233] In addressing the issue, the Grassley Memorandum refers to the recent ruling by the Tax Court in *Driscoll v. Comm'r*,[234] in which the court failed to read section 107(2) as having a limitation on the number of homes that the minister could exclude from gross income.[235]

In *Driscoll*, Petitioner Philip A. Driscoll worked as an ordained minister for Mighty Horn Ministries, Inc., later known as Phil Driscoll Ministries, Inc.[236] During each of the years 1996 through 1999, Mr. Driscoll owned two residences: a principal residence in Cleveland, Tennessee (hereinafter "principal home"),

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226. *See* Grassley Memorandum, *supra* note 10, at 15.

227. Treas. Reg. § 1.107-1(b) (1963), providing evidential qualifications for this payment to be considered parsonage, and thus excludable. Evidence of designation under the regulation may include an "employment contract," "minutes," "resolution," "its budget," and other instruments. The designation is sufficient if it distinguishes the payment of rental allowance from salary or other remuneration.

228. Warnke v. U.S., 641 F. Supp. 1083 (E.D. Ky. 1986).

229. *Id.* at 1087-88.

230. *Id.* at 1088.

231. *Id.*

232. *Id.*

233. Grassley Memorandum, *supra* note 10, at 15.

234. Driscoll v. Comm'r, 135 T.C. 557 (2010), *rev'd per curiam*, 669 F.3d 1309 (11th Cir. 2012).

235. *Id.* at 566.

236. *Id.* at 558.

and a second residence in the Parksville Lake Summer Home area of the Cherokee National Forest in Lake Ocoee (hereinafter "lake house").[237] The ministry filed Form 990, which included amounts described as "parsonage allowance," for each of the four years in question;[238] Mr. Driscoll did not include said allowance in gross income in his tax returns for any those years.[239] The IRS issued a notice of deficiency challenging the parsonage exclusions for the lake house for each year.[240]

The court analyzed section 107(2) as it appeared at the time of the taxable years,[241] which allowed exclusion from gross income "the rental allowance paid to him as part of his compensation, to the extent used by him to rent or provide *a home*."[242] A major sub-issue was whether the phrase "a home" allowed for plurality in application.[243] The court pointed out that the Internal Revenue Code cross-references the Dictionary Act in determining the phrase's meaning.[244] The Dictionary Act, in its pertinent part, provides that "words importing the singular include and apply to several persons, parties, or things."[245] Because the lake house was "a dwelling place of the minister" and satisfied the requirements of section 701(2), it qualified as "a home."[246] Further, the court suggested that, if Congress intended on limiting the minister's exclusion to a single home, it would have used specific language to do so.[247] Mainly for these reasons,

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237. *Id.* at 558-59. Mr. Driscoll owned one lake house from January 1996 through April 1998, but sold it and acquired another lake house that he owned from April 1998 through 1999. *Id.* at 559. For purposes of the legal analysis (and this article), however, this fact is irrelevant. *See id.* at 557.

238. *Id.* at 559.

239. *Id.*

240. *Id.* at 559-60.

241. *See id.* at 557. Subsequent to the taxable years at issue, Congress amended § 107 in an apparent response to the Tax Court's ruling in *Warren*. *Id.* at 561 n.4. In *Warren*, the Court held that "the exclusion from gross income for a designated parsonage allowance is not limited to the lesser of the fair market rental value of the home or the amount used to provide a home." Warren v. Comm'r, 114 T.C. 343, 351 (2000). Section 107 now clearly limits the exclusion to the "fair rental value of the home." I.R.C. § 107 (2002).

242. I.R.C. § 107(2) (1986) (emphasis added), *amended by* Clergy Housing Allowance Clarification Act of 2002, Pub. L. No. 107-181, 116 Stat. 583 (2002) (codified as amended at I.R.C. § 107 (2002)).

243. *Driscoll*, 135 T.C. at 563-65.

244. *Id.* at 565-66 (citing I.R.C. § 7701(p)(1)(1) (previously codified at § 7701(m)(1))).

245. 1 U.S.C. § 1 (2012).

246. *Driscoll*, 135 T.C. at 566.

247. *Id.* at 565 n.17 (explaining that the court's history has been to "requir[e] 'unequivocal' evidence of legislative purpose before construing a section of the Code in a manner that would override the plain meaning of the words used in the section" (citing Warren v. Comm'r, 114 T.C. 343, 349; Zinniel v. Comm'r, 89 T.C. 357, 363-364 (1987))).

the court held that the payments for the lake house were excludable from the minister's gross income.[248]

As mentioned above, the Grassley Memorandum discusses the issue of whether "ministers should receive a parsonage allowance for more than one residence."[249] Citing Congress' intent to ease the financial burden on "small, rural churches" in its attracting and retaining ministers vis-à-vis the larger churches that are able to supply housing, the Grassley Memorandum suggested concern that allowing exclusion for multiple homes may run counter to said intent.[250]

This concern is likely eased by the Eleventh Circuit's reversal of the *Driscoll* decision nearly a year subsequent to the date of the Grassley Memorandum (the reversal of which is hereinafter referred to as "*Driscoll II*").[251] The reversal occurred on two main grounds: 1) the Tax Court's misuse of the Dictionary Act; and 2) the fact that section 107's history does not support the Tax Court's perception of Congress' intent.[252]

Firstly, the circuit court took issue with the Tax Court's use of the Dictionary Act for its decision.[253] Specifically, the court stated, the Internal Revenue Code provides that "any cross references 'are made only for convenience, and shall be given no legal effect.'"[254] Furthermore, "the Dictionary Act, by its own terms, does not apply if 'the context indicates otherwise.'"[255] In this case, the court said that the Dictionary Act does not apply.[256] The circuit court, instead, turns to the Webster's Dictionary, which provides the following definition of "home": "the house and grounds with their appurtenances habitually occupied by a family: one's principal place of residence: DOMICILE."[257] The court understood this definition as providing "decidedly singular connotations."[258]

Secondly, the appellate court turns to the legislative history to provide context for the term "a home."[259] In evoking this

248. *See id.* at 565-56.
249. Grassley Memorandum, *supra* note 10, at 15.
250. *See id.*
251. Comm'r v. Driscoll, 669 F.3d 1309 (11th Cir. 2012).
252. *See id.*
253. *Id.* at 1311-12.
254. *Id.* at 1311 (quoting I.R.C. § 7806(a) (2012)).
255. *Id.* at 1311 (quoting United States v. Hayes, 555 U.S. 415, 422 n.5 (2009)).
256. *Id. at 1311.*
257. *Id.* at 1311-12 (quoting WEBSTER'S THIRD NEW INTERNATIONAL DICTIONARY 1082 (3d ed. 1993)).
258. *Id.* at 1312.
259. *Id.*

history, the court focused on the diction used in the original parsonage exclusion and traced its development into the present day language.[260] Specifically, the court took note of the Revenue Act of 1921 use of the term "a dwelling house"[261] instead of "a home."[262] This version of the parsonage exclusion also did not include situations in which "actual cash flowed from the church to the minister."[263] However, Congress later enacted the Internal Revenue Code of 1954,[264] in which the parsonage exclusion allowed for allowances from the church to the minister,[265] and the words "a dwelling house" were replaced with "a home."[266] The appellate court cited House and Senate reports that explained section 107(2)'s purpose as granting exclusion in a situation in which "a minister, in addition to the home, rents a farm or business property, except to the extent that the total rental paid can be allocated to the home itself."[267] The appellate court accepts the Commissioner's argument that this evinces Congress' intent "for the parsonage allowance exclusion to apply to only one home."[268] The court then considered Mr. Driscoll's argument that "a" is an indefinite article that indicates the exclusion applies to "no particular home."[269] But the court rejected it by citing the Webster's Dictionary, which says that "a" is "used as a function word before most singular nouns other than proper and mass nouns when the individual in question is undetermined, unidentified, or unspecified, especially when the individual is being first mentioned or called to notice."[270]

The Eleventh Circuit's decision in *Driscoll II* finds more support in the law's legislative history than the court mentioned.[271] Despite the appellate court's reasoning being primarily focused on the statute's diction, its conclusion is

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260. *See id.*

261. Revenue Act of 1921, Pub. L. No. 67-98, § 213(b)(11), 42 Stat. 227, 239.

262. *Driscoll*, 669 F.3d at 1312; *Cf.* Revenue Act § 213(b)(11) (excluding from gross income "[t]he rental value of a dwelling house and appurtenances thereof furnished to a minister of the gospel as part of his compensation"); I.R.C. § 107 (1) (2012) (excluding from gross income "the rental value of a home furnished to him as part of his compensation").

263. Grassley Memorandum, *supra* note 10, at 11. *See also* Revenue Act § 213(b)(11).

264. Internal Revenue Code of 1954, Pub. L. No. 591-736, § 107, 68A Stat. 3, 32 (codified at I.R.C. § 107 (2002)).

265. *Id.*

266. *Id.*

267. *Driscoll*, 669 F.3d at 1312 (quoting S. REP. NO. 83-1622, at 186 (1954); H.R. REP. NO. 83-1337, at A35 (1954)).

268. *Id.* at 1312.

269. *Id.*

270. *Id.* at 1312 (citing WEBSTER'S, *supra* note 257, at 1).

271. *See Driscoll*, 669 F.3d at 1311-12; S. REP. NO. 83-1622, at 16 (1954).

bolstered by U.S. congressmen explaining an important purpose behind its application of the exclusion to parsonage allowances.[272] Prior to 1954, there existed a discrepancy of tax treatment between ministers residing in a house provided by the church, and those clergymen for smaller churches who received extra—yet taxable—cash and had to provide homes for themselves.[273] This prompted Congressman Peter Mack to sponsor the provision enacting section 701(2), as he expressed concern for the "55 percent" of clergymen receiving less than the annual median income of the U.S. labor force.[274] The enactment of the exclusion for parsonage allowance is purported to have "removed the discrimination in existing law by providing that the present exclusion is to apply to rental allowances paid to ministers to the extent used by them to rent or provide a home."[275]

Because the purpose of the provision was primarily to provide equal tax treatment for ministers receiving a house and ministers receiving an allowance, Congress surely did not intend to allow an expansive reading of section 701(2) that permits ministers receiving allowances to exclude the purchase or rent of multiple homes.[276] One could argue that under section 107(1), in which the term "a home" is also used, a minister may theoretically exclude from gross income multiple houses furnished by the church, all while still providing equal tax treatment for both section 107(1) and section 107(2) ministers.[277] This logic, however, assumes the premise of a race-to-the-top treatment of this provision that, as just shown, runs counter to its original purpose.[278]

VIII. CONCLUSION

The Internal Revenue Code and the Treasury Regulations are replete with flaws that allow for ill-intending individuals and organizations to take advantage of the tax-exempt status of

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272. *See Driscoll*, 669 F.3d at 1311-12; S. REP. NO. 83-1622, at 16.

273. *See* Grassley Memorandum, *supra* note 10, at 11 (citing Kamron Keele, *A Plea For the Repeal of Section 107: No More Tax-Free Mansions For Dubious "Ministers of the Gospel,"* 56 TAX LAW. 73, 77 (2002)).

274. *See* Grassley Memorandum, *supra* note 10, at 12 (citing *H.R. Comm. on Ways and Means, Hearings on Forty Topics Pertaining to the General Revision of the Internal Revenue Code*, 83rd Cong. 1576 (1953) [hereinafter *Forty Topics*] (statement of Rep. Peter Mack, Member, H. Commerce Comm.)).

275. Grassley Memorandum, *supra* note 10, at 11 (quoting S. REP. NO. 83-1622, at 16 (1954)).

276. *See* Grassley Memorandum, *supra* note 10, at 12-13 (citing Randall Edwards, *Jenkin's Attorney: Home was Parsonage*, Columbus Dispatch (OH), Mar. 18, 1993, at 02C).

277. *See* I.R.C. § 107(1), (2) (2012).

278. *See* S. REP. NO. 83-1622 at 16 (1954).

churches. During a church's beginning stages, it may legally opt to leave the IRS without a clue of its existence.[279] During the course of its existence, a church is not required to be accountable to the IRS.[280] If the IRS were to find out of a church's existence and catch wind of financial misconduct, the Service must clear procedural hurdles to enforce the substantive law.[281] Even at this stage, if it were to be reached, the substantive law is either a) far too cryptic, as is the case of the prohibition of private inurement,[282] or b) full of legal outs provided to the organization or those within it, as in the case of the excise taxes imposed on excess benefit transactions.[283]

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279. *See* I.R.C. § 508(a)(1), (c)(1)(A) (exempting churches from the requirement of notifying the Secretary of the Treasury of their application for recognition as a 501(c)(3) organization).

280. *See id.*

281. *See* I.R.C. § 7611(a) (2012) (requiring a high-level Treasury official to have a reasonable belief that the church is not exempt or that it is conducting non-exempt activities and requiring written notice to the church before any church tax inquiry may commence).

282. *See* I.R.C. § 501(c)(3); Treas. Reg. § 1.501(c)(3)-1 (2008).

283. *See* I.R.C. § 4958; Treas. Reg. § 53.4958-6 (2002).