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Internal Revenue Manual

Part 4. Examining Process

Chapter 12. Nonfiled Returns

Section 2. Frivolous Filers/Non-filers Procedures

4.12.2 Frivolous Filers/Non-filers Procedures

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4.12.2.1 (04-30-1999) Overview

1. This handbook provides information and instruction for frivolous filers/non-filers and organizations claiming to churches, related individuals, and tax avoidance.

4.12.2.2 (04-30-1999) Examination Procedures Applicable to Family Estate Trusts

1. The examination of a family estate trust generally will result in a no-change (with adjustments) to the Form 1041. This is because the income and allowable expenses are transferred to the grantor's Form 1040. An examination of the scheme may, however, results in an overassessment to the trust if a tax liability had been assessed on the return as filed. An overassessment may also be created on a beneficiary's return if a distribution had been made from the trust and the examination results in nonrecognition of the income splitting scheme.
2. When a family estate trust is examined, the examining officer should make every effort to solicit an agreement for the deficiency on the adjusted Form 1040. This may be accomplished by discussion with the taxpayer or his/her representative, as

well as providing the taxpayer or representative copies of the appropriate cases. In appropriate instances, examiners should communicate these cases to taxpayers or representatives by preparing letters appropriate to the case.

3. If the examination results in an agreed Form 1040 (of the grantor), the examiner will make all appropriate adjustments to the related returns under normal procedures.
4. In unagreed family estate trust cases, if examination of the scheme would result in a no-change or an overassessment to the related Form 1041, 1040NR, or beneficiary's Form 1040, then Examination will close these returns to the Service Center and a special notification letter (L-1456(DO),) will be sent to the trust and beneficiaries. This letter advises the taxpayer that the return is being closed with no-change to the reported tax liability. It informs the taxpayer of the Service's position regarding transfer of the income and expenses to the grantor's return, and advises the taxpayer to file a protective claim for refund if a potential overassessment exists on the return.
5. In unagreed cases, the examiner will attach to the front of the grantor's case file a Form 3198, Special Handling Notice, with the following instruction to Examination Support and Processing: "Enclosed is an unagreed case involving the grantor of a family estate trust. Send Special Notification Letter L-1456(DO) to the trust and beneficiaries (list attached)." The examiner will list the names and addresses of the trust and beneficiaries on a sheet of paper and attach it to the back of Form 3198.
6. In unagreed cases, attach Form 1308, Notice to Delay Allowance of Overpayment, to the trust and beneficiary returns to prevent refunds being paid to the trust or beneficiaries prior to the disposition of the grantor's case.
7. In unagreed cases, if the related trust or beneficiary return is a no change or an overassessment, it need not accompany the grantor's case to Appeals. However, the examiner should include the following information in the grantor's case file:
 - A. copy of the related 1041;
 - B. copy of the trust instrument;
 - C. computation of adjustments attributable to the trust return; and,
 - D. the notes in the examiner's workpapers identifying all of the related 1040 returns.
8. Examination of the grantor's Form 1040 should be performed in the area where the grantor resides.
9. During every field and office interview examination, the examiner will determine if return preparer identification and/or conduct violations exist. The procedures in the Penalty handbook, Return Preparers Program, will be followed. Examiners should be alert for situations where a return preparer relationship exists, but no return preparer is identified on the tax return.
10. Taxpayers are responsible for the accuracy of their returns even if they engaged a return preparer. Consideration should be given to referral for criminal prosecution under Section 7201, Attempt to Evade or Defeat Tax, and Section 7203, Willful Failure to File Return, Supply Information, or Pay Tax. In the event a criminal referral is not appropriate, consideration should be given to civil penalties when appropriate. The determination will be made on a case-by-case basis. The facts and circumstances in each case will govern the imposition of a penalty. Guidelines to be used in the application of the negligence penalty imposed by IRC 6662 are found in the penalty handbook IRM 20. Examiners should recommend the assertion of the negligence penalty in appropriate cases. Guidelines to be used in the application of the civil fraud penalty will be found in the penalty handbook IRM 20.

4.12.2.3 (04-30-1999)**Organizations Claiming to Be Churches, Related Individuals, and Tax Avoidance**

1. Examination's involvement with the books and records of churches will generally be limited to those situations where transactions between a church and individuals other than a church relate to the tax liability of those other individuals. In these situations, the Examination may use the usual procedures and summonses described in section 1.4.4.
2. The examination of the books and records of a church for the purposes of determining the initial or continuing qualifications of an organization under IRC 501 (c)(3), whether the church engaged in an excess benefit transaction subject to tax under IRC 4958, whether an organization is one to which deductible contributions may be made, or the amount of tax, if any, imposed by the Code upon the church, are exclusively in the jurisdiction of TEGE. This usually does not include a Form 1120 filed by an organization claiming to be a church that lost its exempt status. In this situation Form 1120 would be under the jurisdiction of Examination.
3. Although a form 1120 filed by a church is under the jurisdiction of Examination, TEGE should be consulted if the church was recognized exempt within five years of the year for which it filed Form 1120, and the issue involves transfer of funds or property to an individual. This is because IRC 4958 contains a "five year lookback rule" under which an excess benefit transaction may be subject to the IRC 4958 taxes if the organization was exempt at any time during the five year period ending on the date of the excess benefit transaction.

4.12.2.3.1 (04-30-1999)**Field Territory Managers Guidelines for Cases Involving IRC 170(c) Contribution Deductions and Assignment of Income**

1. IRC 7611 contains strict procedures for Service contacts with churches. Generally, by enacting IRC 7611, Congress increased the restrictions on the Service concerning church tax inquiries and examinations. As explained in the Conference Report accompanying the Deficit Reduction Act of 1984, H.R. Rep. No. 98-861, 98th Cong., 2d Sess. 1101(1984), 1984-3 C.B. Vol. 2 355, two competing considerations motivated Congress. While wanting to protect churches from undue interference by the Service, Congress recognized that an increasing number of taxpayers had, in recent years, used the church form primarily as a tax avoidance device. Congress believed that the Service can pursue individuals who use the church form in this manner.
2. The guidelines provided herein are intended to aid examiners in gathering sufficient facts in each case to resolve the issues. The examiner's goal is to complete the examination whenever possible, without having to request a collateral examination by TEGE.
3. As explained in 1.4.4 of this handbook, the restrictions of IRC 7611 do not apply when the examination or inquiry relates primarily to the tax status or liability of persons other than the church, rather to the tax status of the church itself. These inquiries or examinations may include, but are not limited to:
 - A. inquiries or examinations regarding the inurement of church funds to a particular individual or individuals or to another organization, which may result in the denial of all or part of such individual's or organization's deduction for charitable contributions to the church, unless the examination may result in the excise tax on excess benefit transactions imposed by IRC 4958.
 - B. inquiries or examinations regarding the assignment of income or services or contributions to a church, or

- C. inquiries or examinations regarding a vow of poverty by an individual or individuals followed by a transfer of property or an assignment of income or services to the church.
4. The examiner may inquire of a church regarding these matters without being considered to have commenced a church tax inquiry and may proceed to examine church records relating to these issues (including enforcement of a summons for access to such records) without following the requirements applicable to church tax examinations, subject to the general rules regarding examinations of taxpayer books and records.
 5. Congress intended that inquiries or examinations conducted outside the church audit procedures will be limited to the determination of facts and circumstances specifically relating to the tax liabilities of the individuals or other organizations in question. For example, in an inurement case, the IRS could request information or examine church records regarding amounts of money, property, or services transferred to the individual or individuals in question (including wages, loans, or non-contractual transfers), the use of church funds for personal expenses, or other similar matters, outside of the church audit procedures. In an assignment of income case, the IRS could request information or examine church records relevant to an individual's assignment of particular income, donation or property, or transfer of a business to a church.

4.12.2.4 (04-30-1999)

Actions Not Subject to the Church Tax Inquiry and Examination Procedures of IRC 7611

1. IRC 7611 was enacted to expand the protection of IRC 7605(c) and Treas. Reg. 301.7605-1(c) provided the Service minimize contacts with churches to only those necessary to insure compliance with the tax laws.

4.12.2.4.1 (04-30-1999)

General

1. The Tax Reform Act of 1984 added IRC Section 7611, which supersedes IRC 7605 (c) and sets restrictions and guidelines that the Service must follow in any tax inquiry or examination of a church, or any organization claiming to be a church. IRC 7611 would also apply to a Form 1120 filed by an organization claiming to be a church but which has lost its exempt status. A "church tax inquiry" is defined as any inquiry to a church (other than an examination) to serve as a basis for determining whether a church—
 - A. is exempt from tax under 501(a) because of its status as a church, or
 - B. is carrying on an unrelated trade or business (within the meaning of IRC 513) or otherwise engaged in activities that may be subject to taxation.
2. Under section 7611, the Service may begin a church tax inquiry only when the appropriate Area Director (or higher Treasury official) reasonably believes, based on facts and circumstances recorded in writing, that the organization may not qualify for tax exemption as a church; maybe carrying on an unrelated trade or business (within the meaning of section 513); or may be otherwise engaged in activities subject to tax.
3. The information supporting a reasonable belief can be obtained from many sources, including but not limited to newspaper or magazine articles; television and radio reports (a transcript should be obtained, if possible); documents on file with the Service (e.g., a Form 990-T filed by the church); records concerning the church in the possession of third parties; or informants. A Form 1120 filed by an organization claiming to be a church would satisfy the reasonable belief requirement.

4. The facts and circumstances forming the basis for a reasonable belief must be derived from information lawfully obtained by the Service. Information obtained from informants must not be known to be unreliable.
5. The failure of a church to respond to repeated (two or more) inquiries concerning the tax liability of other persons or to routine requests by the Service may be considered a reasonable basis to commence a church tax inquiry.
6. The failure of a church to respond to repeated (two or more) requests by the Service for information needed to locate third-party records is a factor, but not a conclusive factor, in determining if there is reasonable cause for commencing a church tax inquiry. The requests along with the failures to respond, should be documented by the function making the requests. If, after informal discussions with TEGE, the requesting function believes that a church tax inquiry is still warranted, the formal request will be made in writing to the Field Territory Manager of the key area servicing the requesting area or service centers. Whether the matter should be referred to TEGE or worked in Examination depends on who has jurisdiction over the return filed by the church. While in most cases this will be TEGE, Examination does have jurisdiction over a Form 1120 filed by a revoked (or otherwise non-exempt) church. Examination cannot audit a Form 1120 of an organization claiming to be a church without following the procedures of IRC 7611, even though the organization is not tax exempt.
7. All contacts with a church, no matter how informal or well-intentioned, must be made under the provisions of IRC 7611 unless they fall under one of the exceptions listed in sections 1.4.2 through 1.4.6 of this handbook.
8. The restrictions of IRC 7611 do not apply to an examination of a religious organization that does not claim to be a church.
9. IRC 7611 specifically excludes certain Service inquiries to churches from the restrictions it imposes. These exclusions are discussed in sections 1.4.2 through 1.4.6 of this handbook.

4.12.2.4.2 (04-30-1999) **Third-Party Records**

1. The restrictions of IRC 7611 do not apply to records relating to the church held by third parties, such as canceled checks in the possession of a bank. If the documents are not provided voluntarily after the request, a summons under section 7602 may be issued. If the records are held by a third-party recordkeeper as defined in section 7609(a)(3), the procedures in section 7609 must be followed, see summons handbook.
2. The restrictions of IRC 7611 do not apply to requests made to the church for information needed to locate third-party records. Such information includes the church's chartered name, the state and year in which it was incorporated, and the location of its bank accounts. Section 1.4.1:(6) discusses the effect of a church's failure to provide such information.
3. Information obtained from third-party records may provide the "reasonable belief", as discussed in section 1.4.1:(2), necessary to initiate a church tax inquiry and examination. However, the Service may not determine that a church is not entitled to exemption, impose an excise tax under IRC 4958 on an excess benefit transaction engaged in by a church or assess tax on unrelated business income against a church solely on the basis of third-party records, without first complying with the procedures of IRC 7611. This limitation does not apply to assessments of tax other than income tax resulting from loss of exemption or for unrelated business income (for instance, assessments of social security or other employment taxes). A church's failure to provide information necessary to locate third-party records may be a factor in determining if there is reasonable cause for commencing a church tax

inquiry.

4.12.2.4.3 (04-30-1999)

Routine Requests

1. The restrictions of IRC 7611 do not apply to routine requests.
2. Routine requests include requests for information concerning:
 - A. the filing or failure to file any tax or information return;
 - B. compliance with income tax or FICA withholding responsibilities;
 - C. supplemental information needed to complete the mechanical processing of any incomplete or incorrect return filed;
 - D. information needed to process letter ruling requests or applications for exemption or foundation classification;
 - E. information necessary to process and periodically update registrations for tax-free transactions (excise tax), elections for exemption from windfall profits tax; or employment tax exemption requests by a church;
 - F. information identifying a church that is used by the Service to update its Cumulative List of Tax Exempt Organizations (publication No. 78) and other computer files; and
 - G. confirmation that a specific business is or is not owned or operated by a church.
3. Repeated (two or more) failures by the church to respond to routine requests may support a reasonable belief for commencement of a church tax inquiry.

4.12.2.4.4 (04-30-1999)

Inquiry or Examination Concerning Tax Liability of a Person or Organization Other Than a Church

1. The restrictions of IRC 7611 usually does not apply to inquiries or examinations to determine the tax status or liability of a person or organization other than the church, though such inquiries or examinations will not be routinely undertaken. When circumstances warrant, the Service can do the following without complying with the provisions of IRC 7611 when the information is requested during an examination or investigation of a person or organization other than a church:
 - A. Request information or inspect church records regarding amounts of money, property, or services transferred to the person or persons in question, including wages or salary, loans, or other transfers;
 - B. Request information or inspect church records concerning the use of church funds for personal expenses of the person or persons in question; or
 - C. Request information or inspect church records relevant to a person's assignment of income, donations of property or transfer of a business to a church.
2. If an inquiry concerns payments to, or transactions with an individual who may be a "disqualified person" under IRC 4958 (generally, someone in a position to exercise substantial influence over the affairs of the church), Examination should coordinate with TEGE, as the individual may be subject to the taxes imposed by IRC 4958 on

excess benefit transactions. An inquiry, or an examination of a church to determine if it engaged in an excess benefit transaction is conducted by TEGE and is subject to the IRC 7611 procedures.

3. Examination of church records to determine the liability of persons or organizations other than the church cannot be used to avoid the intended purpose of IRC 7611. For example, the Service should not seek to examine a contributor or membership list in the possession of a church, without observing the restrictions of IRC 7611, if the purpose for seeking the list is to determine the overall financial structure of the church, rather than verifying a contribution from an individual. The contributor list should also not be used to target individuals for an examination. However, information learned during an examination of church records to determine the liability of individuals or organizations other than the church may support a reasonable belief to commence a church tax inquiry.
4. Inquiries or examinations concerning the tax liability of a person or organization other than a church are subject to the general rules regarding examinations of taxpayer books and records.

4.12.2.4.5 (04-30-1999)

Criminal Investigations, Failure to File, Etc.

1. The restrictions of IRC 7611 do not apply to: any criminal investigation; any willful attempt to defeat or evade any tax; or any knowing failure to file a return.

4.12.2.4.6 (04-30-1999)

Certain Assessments of Tax

1. The restrictions of IRC 7611 do not apply to termination assessments under IRC 6851 or jeopardy assessments under IRC 6861.

4.12.2.4.7 (04-30-1999)

Church Tax Inquiries and Examinations

1. The church tax inquiry procedure provides an opportunity for the church to satisfy the Service's concerns expeditiously without a formal examination. The church tax inquiry procedures are not synonymous with the pre-examination letter procedures of prior law. While church tax inquiries and church examinations are usually done by and are under the jurisdiction of TEGE (a Form 1120 filed by an organization claiming to be a church is worked by Examination), it is important that Examination personnel involved with church related issues are generally aware of the procedures involved with a church tax inquiry and examination under IRC 7611. Only an overview of these procedures is presented here. For a comprehensive discussion of the church tax inquiry and examination procedures, see the former IRM 7(10)71.
2. Once the reasonable belief requirements in section 1.4.1:(2) have been met, the TEGE key Area (Examination, in the case of Form 1120) prepares the church tax inquiry notice for the Area Director's signature.
3. IRC 7611(a)(3)(B) requires that the notice include:
 - A. an explanation of the concerns giving rise to and the general subject matter of the inquiry. This should be sufficiently specific to enable the church to understand the particular area of church activities or behavior at issue. The Service is not required to share particular items of evidence with the church, or to identify its source of information, if providing such information would be damaging to the inquiry or the Service's sources.
 - B. a general explanation of the provisions of the Internal Revenue Code that

authorize the inquiry or that otherwise may be involved in the inquiry.

- C. a general explanation of applicable administrative and constitutional provisions with respect to the inquiry including the right to a conference with the Service before an examination of church records.
4. Although not required by IRC 7611, the notice of church tax inquiry should include a list of questions relevant to the inquiry. The particular questions asked will depend on the information in the Service's possession and the reasons for the inquiry. The letter should not request the church to submit church records, as these records may be inspected only on examination.
 5. IRC 7611 imposes strict time limits on church tax inquiries. The church must be allowed a minimum of 15 days to respond to the church tax inquiry notice. Therefore, a notice of examination cannot be sent until at least 15 full days after the notice of inquiry is sent. If a notice of examination is not sent within 90 days from the date of the notice of tax inquiry, the inquiry must be terminated with no change to the organization's tax status or liability.

4.12.2.4.8 (04-30-1999) Church Tax Examination

1. When the church fails to respond to the notice of church tax inquiry or any follow-up letter, or when the church's response does not resolve the Service's concerns, the TEGE Key area will prepare a notice of examination for the signature of the Area Director .
2. The notice of examination cannot be mailed until 15 days after date of the notice of church tax inquiry was mailed and must be mailed at the least 15 days before the date the examination begins. A final determination must be made within 2 years from the notice of examination.
3. The notice of examination must be signed by the Area Director.
4. A copy of the notice of examination must be provided to the Area Counsel at the time the notice is mailed to the organization. The Area Counsel has 15 days to provide a nonbinding advisory opinion to the Area Director. The Area Director will take any objection by the Area Counsel into account when determining whether to proceed with the examination.
5. The notice of examination must contain:
 - A. a copy of the church tax inquiry notice;
 - B. a description of the church records and activities the Service seeks to examine;
 - C. an offer of a conference between the church and the Service to resolve concerns relating to such examination; and
 - D. a copy of all documents collected or prepared by the Service for use in the examination, disclosure of which is required by the Freedom of Information Act (5 U.S.C. 552), as supplemented by IRC 6103 (relating to disclosure and confidentiality of tax return information). Documents that would be exempt from disclosure under the Freedom of Information Act or IRC 6103 need not be furnished to the church. The Service is not required to furnish all documents it may have on the organization, only those that were used to determine that an inquiry and examination were necessary. Documents that would reveal the existence or identity of a confidential informant shall not be provided to the church.

6. When signed by the Area Director the notice of examination will be mailed from the area. The notice must be mailed "certified mail, return receipt requested." The signed return receipt, or return receipt evidencing refusal to accept the letter, must be attached to the file copy of the notice of examination. The memorandum to the Area Counsel should be transmitted when the notice of examination is mailed.
7. After the notice is mailed, the case file should be returned to the initiating key area office. The key area is responsible for monitoring the statutory time limit for completing the examination. The key area should calculate the two year examination period from the date the notice of examination was mailed and note it prominently on the front of the file. The expiration date of the two-year period for completing the examination should be determined and noted prominently on the front of the file.
8. Delegation Order No. 137 (Rev. 2), Authority to Perform Functions Relating to Church Tax Inquiries and Examinations, in the former IRM 1229, Handbook of Delegation Orders, authorizes Area Directors to hold conferences described in (5) (c) above and to execute agreements to suspend the periods for completing church tax inquiries or examinations. The authority to perform these functions may be redelegated no lower than group manager level.

4.12.2.4.9 (04-30-1999)

Limitations on Additional Inquiries and Examinations

1. No church tax inquiry or examination may begin for a five year period unless the previous examination resulted in a revocation, notice of deficiency or assessment, or a request for any significant change in church operations, including a significant change in accounting practices.
2. The five year limitation period referred to in paragraph (1) begins on the date the notice of examination was mailed to the church in connection with a previous examination. If the Service previously issued a church tax inquiry notice, but did not proceed to issue a notice of examination, the five year limitation period begins on the date the notice of inquiry was mailed. If the 90-day period or the two-year period was suspended in the earlier inquiry or examination, the five-year limitation period is extended for a time equal to the length of the earlier suspension, unless the prior examination was actually concluded within two years of the notice of examination.
3. The five year limitation on a church inquiry or examination does not apply under the following conditions:
 - A. Approval in writing is obtained from the Director, Compliance (Tax Exempt and Government Entities), or
 - B. The issues involved are not the same as or similar to the issues involved in the previous inquiry or examination. A determination of similarity of issue depends on the substance rather than legal classification. For example, unrelated business income from a different source will be considered as involving a different issue.

4.12.2.5 (04-30-1999)

Disclosure to Correct Misstatement of Fact

1. IRC Section 6103(k)(3) allows the Director , subject to the approval of the Joint Committee on Taxation, to disclose return information or any other information necessary to correct misstatements of fact when it is determined that such a correction of the record is necessary for tax administration purposes. (See Policy Statement P-1-185).
2. All examination personnel should be alert to situations where we should be pursuing Joint Committee approval to correct misstatements of fact. An example would be

when leaders promoting frivolous argument schemes make false claims about their personal tax situations and IRS dealings with them. In such situations, as is explained in text (11)30 of the former IRM 1272, Disclosure of Official Information Handbook, the local Disclosure Officer should be informed immediately.

Exhibit 4.12.2-1 (04-30-1999) Family Estate Trust—Special Notification Letter

Date: Person to Contact:
Contact Telephone Number:
Refer Reply to:
Form: 1041
Name of Trust:
Tax Year(s):

We are closing this case with no change to the tax liability shown on the above return.

[] In a related case, the Internal Revenue Service has taken the position that the gross income of the trust and all allowable deductions are those of the trust grantor and were reported in error by the trust. If this position is sustained, there may be an overassessment (decrease in tax) on the trust return.

[] In a related case, the Internal Revenue Service has taken the position that the gross income of the above trust and all allowable deductions are those of the trust grantor. If this position is sustained, distribution from the trust will not be taxable to you, and there may be an overassessment (decrease in tax) on your income tax return. If there is a potential overassessment on your return, to protect yourself against expiration of the statute of limitations for the tax years involved, you should file a claim for refund or an amended return within the time prescribed by law. However, if the statute of limitations has expired, the relief provisions of sections 1311 through 1314 of the Internal Revenue Code may apply.

Sincerely yours,

Area Director

Exhibit 4.12.2-2 (04-30-1999) Area Director's Letter Approving Examination of Church Books of Account

(To be individually typed on appropriate letterhead)
Notice of Church Examination Second Letter

Person to Contact:
Contact Telephone Number:
CERTIFIED MAIL

Dear Sir or Madam:

On (enter date or dates), we sent you a Notice of Church Tax Inquiry within the meaning of section 7611(a) of the Internal Revenue Code to notify you of concerns we have about your [tax liability] [exempt status]. A copy of that letter and a copy of the information that caused our concern are attached as required by section 7611(b)(3) of the Code.

(The following paragraph should be used if the organization responded to the church tax inquiry)

[[Thank you for your letter of [enter date], in response to the Notice of Church Tax Inquiry. However, we still think an examination of [describe

records or activities to be examined] may be necessary to resolve our concerns. Accordingly, as provided by law, we are sending this Notice of Church Examination. Before we begin an examination or take action based on information in our possession, you have the right to a conference with Service officials to try to resolve our concerns and alleviate the need for further action. A conference may help define the issues and limit the scope of any examination. You must request a conference before the beginning of an examination, which will not begin sooner than 15 days from the date of this letter.]]

(The following paragraph should be used if the organization has not responded to the church tax inquiry notice and any follow-up)

[[We have no record of receiving a reply to the Notice of Church Tax Inquiry. Accordingly, as provided by law, we are sending this Notice of Church Examination. If you do not provide information to answer our questions within 15 days of the date of this letter and you do not request the conference you are afforded by section 7611(b)(2)(B) of the Code, we may undertake an examination of [describe records and activities to be examined]. You have the right to a conference to attempt to resolve our concerns before we begin an examination. You must request the conference before the beginning of the examination, which may not begin until 15 days after the date of this letter.]]

(The following paragraphs may be appropriate in certain exceptional cases if the Service possesses information to issue an adverse determination without formal examination).

[We initiated a church tax inquiry and, as provided by law, we are sending this Notice of Church Examination to obtain information that we think is material to a determination of your tax status. If you fail to provide this information in a satisfactory and timely manner, the Service may in lieu of examination make a determination in your case based on the information we now possess or may acquire from other sources. This determination could result in a proposal to (revoke) (deny) your exemption from Federal income tax. Before we begin an examination or take action based on information in our possession, you have the right to a conference with Service officials to try to resolve our concerns and alleviate the need for further action.]

[If we determine you are not exempt, the Service will notify the appropriate State officials, in accordance with section 6104(c) of the Code, that you are not an organization described in section 501(c)(3). The Service will also consider your organization to be a taxable entity.]

(The following paragraphs should be used in all cases).

We have enclosed a copy of all documents collected or prepared by the Service for use in the examination and disclosure of which is required by the Freedom of Information Act (5 U.S.C. 552), as supplemented by section 6103 of the Code (relating to disclosure and confidentiality of tax return information).

If you would like a conference, please contact the person whose name and telephone number are listed above to arrange a mutually convenient time. If we do not hear from you within 15 days from the date of this letter, you will be contacted to arrange a time for the examination or you will be notified of the action the Service will take based on information in our possession.

Thank you for your cooperation.

Sincerely yours,

Area Director

Enclosures

Copy of Church Tax Inquiry Notice and Enclosures

Other Documents Required by IRC 7611(b)(3)

Letter 1904(P) (Rev. 2-85)

Exhibit 4.12.2-3 (04-30-1999) Statement of Administrative and Constitutional Rights

The First Amendment of the Constitution provides that "Congress shall make no law respecting an establishment of religion or prohibiting the free exercise thereof. . ." The first clause is referred to as the Establishment

Clause; the second is the Free Exercise Clause. The Establishment Clause prohibits government sponsorship of religion. Central to this prohibition are the concepts of government neutrality and the separation between church and state. The Supreme Court has held that the Free Exercise Clause of the First Amendment is an absolute prohibition against the regulation of religious beliefs. The First Amendment provides substantial protection for lawful conduct grounded on religious beliefs. However, the government may limit religiously motivated conduct when the limitation is essential to accomplish an overriding governmental interest.

Section 7611 of the Internal Revenue Code provides the following protections to organizations claiming to be churches or conventions or associations of churches:

- (1) The IRS may begin a church tax inquiry only if an IRS Area Director reasonably believes, on the basis of facts and circumstances recorded in writing, that an organization claiming to be a church or convention or association of churches may not qualify for exemption, may be carrying on an unrelated trade or business (within the meaning of section 513 of the Code), or may otherwise be engaged in taxable activities.
- (2) If a tax inquiry is begun, the IRS is required to provide written notice at the beginning of the inquiry. The Notice of Church Tax Inquiry must contain an explanation of the concerns that gave rise to the inquiry and the general subject matter of the inquiry. It must also contain an explanation of the provisions of the Code that authorize the inquiry and a general explanation of applicable administrative and constitutional provisions with respect to the inquiry.
- (3) If the IRS wishes to examine a church's records or religious activities, the Area Director must personally approve the examination and must provide an additional written notice (Notice of Church Examination) to the church at least 15 days prior to the examination. At the same time notice is given to the church, the Area Director must notify the appropriate IRS Area Counsel of the proposed examination. The Area Counsel is then allowed 15 days to file a nonbinding advisory opinion about the examination. The church's Notice of Church Examination is required to include the following: copy of the Notice of Church Tax Inquiry previously provided; a description of the church records and activities which the IRS wishes to examine; a copy of all documents collected or prepared by the IRS for use in the examination that are required to be disclosed under the Freedom of Information Act (5 U.S.C. 552) as supplemented by section 6103 of the Code; and an offer of a conference with the IRS to discuss the concerns which gave rise to the inquiry and the general subject matter of the inquiry prior to the examination. The Notice of Church Examination sent to the church may be mailed no less than 15 days after the Notice of Church Tax Inquiry. The Notice of Church Examination however must generally be mailed within 90 days after the Notice of Church Tax Inquiry or the IRS is required to end the inquiry without change to the church's tax status.
- (4) Failure of the IRS to substantially comply with the above requirements may result in a stay of summons enforcement proceedings to gain access to church records until the requirements are satisfied.
- (5) The IRS is generally required to complete any church inquiry or examination not later than two years after the date on which the Notice of Church Examination was mailed to the church. The two-year period may be extended by mutual agreement between the church and the IRS. It is also suspended during certain judicial proceedings and during any period in excess of 20 days but not in excess of six months, during which a church or its agents fail to comply with any reasonable IRS request for church records or other information. However, in the case of a church tax inquiry in which there is no Notice of Church Examination, the IRS is generally required to complete the inquiry within 90 days after the date on which the Notice of Church Tax Inquiry was mailed to the church.
- (6) The IRS is limited initially to an examination of church records relevant to the church's tax-exempt status for the three most recently completed tax years preceding the date of the Notice of Church Examination. If the church is not exempt for any of these three years the IRS may examine relevant records for the six completed tax years immediately preceding the Notice of Church Examination. Church records of a year earlier than the third or sixth

completed taxable years may be examined if material to a determination of tax-exempt status during the three or six-year period. For examinations relating to unrelated business taxable income, when no return is filed, the IRS may assess tax for the six most recently completed taxable years preceding the date of the Notice of Church Examination. Church records of a year earlier than the sixth year may be examined if material to a determination of unrelated business income tax liability during the six year period. For examinations involving issues other than determination of exempt status or unrelated business income tax liability, there is no limit on the taxable periods that may be examined if no return has been filed. If a tax return has been filed by a church, the normal rules for determining tax liability or assessing tax apply. In addition, if there has been a willful attempt to defeat or evade tax, a knowing failure to file a return, or if there is a criminal investigation, the provisions of section 7611, including any special limitation periods, do not apply.

(7) The IRS Area Counsel must approve, in writing, an adverse determination concerning the tax-exempt status of an organization claiming to be a church, an adverse determination concerning the right of an organization claiming to be a church to receive tax deductible contributions, or the issuance of a notice of tax deficiency to a church following a church tax examination.

(8) Organizations claiming to be churches are entitled to bring a declaratory judgment action under section 7428 once the IRS issues a revenue agent's final report proposing to revoke or deny the church's tax exempt status.

(9) If an inquiry or examination is begun within five years of the date of the Notice of Church Examination (or if no Notice of Church Examination is sent, a Notice of Church Tax Inquiry), it must be approved by the IRS Director, Compliance for Tax Exempt and Government Entities. This approval is not required if the second examination does not involve the same or similar issues as the preceding inquiry or examination or if the first inquiry or examination resulted in a change to the organization's exempt status, an assessment of unrelated business income tax or other tax, or a recommendation for a substantive change in the church's operations, including accounting practices.

Notice 729(2-85)

Exhibit 4.12.2-4 (04-30-1999)
Church Tax Inquiry Letter (Letter 1745(P))
Date last amended 10/25/1996

(To be individually typed on appropriate letterhead)

Church Tax Inquiry Letter

Person to Contact:

Contact Telephone Number:

CERTIFIED MAIL

Dear Sir or Madam:

The Internal Revenue Service is responsible for administering the Internal Revenue laws of the United States, including those that apply to organizations exempt from Federal income tax. To carry out that responsibility, section 7602 of the Internal Revenue Code authorizes the Service to determine the correctness of any tax return, make a return when none has been filed, or to determine the tax liability of any person or

organization. However, section 7611 imposes restrictions on the Service in conducting tax inquiries and examinations of churches and conventions or associations of churches.

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

Because I reasonably believe that you may [not be tax-exempt as a church under section 501(a)] [or that you may] [be liable for federal income or other tax], this letter is notice of the beginning of a church tax inquiry under section 7611(a). I am sending this letter because I believe it is necessary to resolve questions about your [liability for unrelated business income tax] [liability for employment taxes] [tax-exempt status as a church under section 501(a)]. Our concerns are caused by (insert explanation).

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

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

[Please reply within 15 days of the date of this letter to the (insert area office official and address). If we do not hear from you within that time, we may issue a Notice of Church Examination letter, as explained in the attached statement of rights.] If you have any questions, please contact the person whose name and telephone number are shown above.

Thank you for your cooperation.

Sincerely yours,

Area Director

Enclosure[s]:

[Questions]

Statement of Administrative and Constitutional Rights

Letter 1745(P) (Rev. 9-86)

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