

DEPARTMENT OF THE TREASURY
Internal Revenue Service
26 CFR Part 1

Exempt Organizations Not Required
To File Annual Returns: Integrated
Auxiliaries Of Churches

AGENCY: Internal Revenue Service
(IRS), Treasury.

ACTION: Final regulations.

SUMMARY: This document contains final regulations that exempt certain integrated auxiliaries of churches from filing information returns. These regulations incorporate the rules of Rev. Proc. 86-23 (1986-1 C.B. 564), into the regulations defining integrated auxiliary for purposes of determining what entities must file information returns. The new definition focuses on the sources of an organization's financial support in addition to the nature of the organization's activities.

DATES: These regulations are effective December 20, 1995.

For dates of applicability of these regulations, see §1.6033-2(h)(6).

FOR FURTHER INFORMATION CONTACT: Terri Harris or Paul Accettura, of the Office of the Associate Chief Counsel (Employee Benefits and Exempt Organizations), IRS, at 202-622-6070 (not a toll-free number).

Background

On December 15, 1994 proposed regulations §§1.6033-2 and 1.508-1 [EE-41-86 (1995-1 C.B. 841)] under sections 6033(a)(2) and 508 of the Internal Revenue Code of 1986, respectively, were published in the Federal Register (59 FR 64633). The proposed regulations adopted the rules of Rev. Proc. 86-23 (1986-1 C.B. 564) as the definition of integrated auxiliary of a church replacing the current definition set forth in §1.6033-2(g)(5). Additionally, section 508(c) excepts integrated auxiliaries of a church from the requirement that new organizations notify the Secretary of the Treasury that they are applying for recognition of section 501(c)(3) status (Form 1023). For consistency, §1.508-1(a)(3)(i)(a), which gives several examples of integrated auxiliaries, was proposed to be amended by deleting the examples and by adding a cross-reference to §1.6033-2(h) for the definition of integrated auxiliary of a church. After IRS and Treasury consideration of the public comments received regarding the proposed regulations, the regulations are adopted as revised by this Treasury decision.

Explanation of Provisions

Section 6033(a)(1) requires organizations that are exempt from income tax under section 501(a) to file annual returns. Section 6033(a)(2)(A) provides exceptions to this requirement for certain specified types of organizations, including, among others, churches, their integrated auxiliaries, and conventions or associations of churches. Section 6033(a)(2)(B) provides that the Secretary may relieve any organization from the filing requirement where the Secretary determines that filing is not necessary to the efficient administration of the internal revenue laws.

Prior to this Treasury decision, §1.6033-2(g)(5)(i) defined the term integrated auxiliary of a church as an organization that is: (1) exempt from taxation as an organization described in section 501(c)(3); (2) affiliated with a church (within the meaning of §1.6033-2(g)(5)(iii)); and (3) engaged in a principal activity that is “exclusively religious.” Section 1.6033-2(g)(5)(ii) provides that an organization’s principal activity is not “exclusively religious” if that activity is educational, literary, charitable, or of another nature (other than religious) that would serve as a basis for exemption under section 501(c)(3).

The “exclusively religious” element of the definition was litigated in *Lutheran Social Service of Minnesota v. United States*, 583 F. Supp. 1298 (D. Minn. 1984), *rev’d* 758 F.2d 1283 (8th Cir. 1985), and *Tennessee Baptist Children’s Homes, Inc. v. United States*, 604 F. Supp. 210 (M.D. Tenn. 1984) *aff’d*, 790 F.2d 534 (6th Cir. 1986). While the litigation over the “exclusively religious” standard was proceeding, Congress enacted section 3121(w) of the Internal Revenue Code, Tax Reform Act of 1984, Pub. L. 98-369, section 2603(b), 98 Stat. 494, 1128 (1984), which permits certain church-related organizations to elect out of social security coverage if they meet a standard based on the degree of financial support they receive from a church. In light of this litigation and the enactment of section 3121(w), IRS personnel met with representatives of various church organizations to encourage voluntary compliance with the filing requirements and to develop a less controversial and more objective standard for identifying an integrated auxiliary of a church.

Subsequent to these meetings the IRS published Rev. Proc. 86-23, which provides that, for tax years beginning after December 31, 1975, an organization is not required to file Form 990 if it is: (1) described in sections 501(c)(3) and 509(a)(1), (2), or (3); (2) affiliated with a church or a convention or association of churches; and (3) internally supported. With respect to this last criterion, Rev. Proc. 86-23 sets forth an internal support standard that is similar to the financial support standard in section 3121(w).

The proposed regulations adopted the rules of Rev. Proc. 86-23 as the definition of the term integrated auxiliary of a church replacing the current definition set forth in §1.6033-2(g)(5).

The final regulations retain the definition of an integrated auxiliary of a church that is contained in the proposed regulations.

Under this Treasury decision, to be an integrated auxiliary of a church an organization must first be described in section 501(c)(3) and section 509(a)(1), (2), or (3), and be affiliated with a church in accordance with standards set forth in the regulations. An organization meeting those tests is an integrated auxiliary if it either: (1) does not offer admissions, goods, services, or facilities for sale, other than on an incidental basis, to the general public; or (2) offers admissions, goods, services, or facilities for sale, other than on an incidental basis, to the general public and not more than 50 percent of its support comes from a combination of government sources, public solicitation of contributions, and receipts other than those from an unrelated trade or business.

Some commentators have noted that certain church-related organizations that finance, fund and manage pension programs were originally excused from filing by Notice 84-2 (1984-1 C.B. 331), which was issued pursuant to the Commissioner’s discretionary authority under section 6033(a)(2)(B). Rev. Proc. 86-23 states that Notice 84-2 is superseded by Rev. Proc. 86-23 because the organizations excused from filing under the notice are excused from filing by the revenue procedure. The commentators have expressed concern that the proposed regulations did not relieve church pension plans described in Notice 84-2 from the filing requirement. The organizations excused from filing under Notice 84-2 do not necessarily meet the definition of an integrated auxiliary of a church under these final regulations. Nevertheless, the proposed regulations were not intended to alter the exemption from filing provided in Notice 84-2 and reaffirmed in Rev. Proc. 86-23. To make this intent clear, the IRS is issuing Revenue Procedure 96-10 at the same time that it issues these final regulations. Rev. Proc. 96-10 carries over the exemption from filing for church pension plan organizations that was set forth in Notice 84-2. Having reaffirmed those parts of Rev. Proc. 86-23 that were not incorporated into these final regulations, Rev. Proc. 96-10 also obsoletes Rev. Proc. 86-23.

The IRS developed the internal support test contained in the proposed

regulations based on its conclusion that Congress intended that organizations receiving a majority of their support from public and government sources, as opposed to those receiving a majority of their support from church sources, should file annual information returns in order that the public have a means of inspecting the returns of these organizations. The annual information return also was intended to serve as a means by which the IRS could examine, if necessary, those organizations receiving substantial non-church support.

One commentator has suggested that the definition of an integrated auxiliary of a church should consist of a church-related structural test rather than an internal support test. The IRS and the Treasury Department believe that the use of a structural test could lead to problems similar to those caused by the “exclusively religious” test. Additionally, the suggested definition would frustrate Congress’ intended objective of allowing ongoing public scrutiny of organizations receiving the majority their support from public and government sources.

A commentator has also suggested that by using the internal support test as part of the new definition of an integrated auxiliary of a church, the IRS is attempting to “overrule” the holdings in the previously mentioned court cases (*i.e.* *Tennessee Baptist Children’s Home* and *Lutheran Social Service of Minnesota*). The IRS and the Treasury Department believe that the courts’ rulings questioned the validity of the “exclusively religious” activity requirement contained in the former regulation on the basis that it is not within the Service’s discretion to assess the religious nature of a church’s activities. Having eliminated the “exclusively religious” activity test from the definition of integrated auxiliary of a church, the IRS and the Treasury Department believe that the definition in the final regulation is consistent with the courts’ holdings as well as the statute and the legislative history.

Some commentators have suggested that the first sentence of §1.6033-2(g)(5)(iv) of the regulations in effect prior to this Treasury decision should be included in the final regulations. That sentence identified specific types of organizations as integrated auxiliaries of churches in accordance with legislative history. Although §1.6033-2(h) of the proposed regulations was

intended to provide a general definition that could apply in all instances, the IRS and the Treasury Department agree that, in order to be consistent with the legislative history, parts of §1.6033-2(g)(5)(iv) of the regulations should be included in these final regulations. Therefore, these final regulations include §1.6033-2(h)(5) that states that "a men's or women's organization, a seminary, a mission society, or a youth group" is an integrated auxiliary of a church regardless of whether it meets the internal support test in to §1.6033-2(h)(1)(iii). (The tests under §1.6033-2(h)(1)(i) and (ii) must still be met.)

Comments were received objecting that *Example 4* relating to seminaries did not describe a realistic set of facts and, therefore, could lead to confusion. Accordingly, *Example 4* has been eliminated. Also, the treatment of seminaries has been clarified by §1.6033-2(h)(5). We also note that, in addition to the exception for seminaries, §1.6033-2(g)(1)(vii) of the regulations excepts certain schools below college level that are affiliated with a church or operated by a religious order from the filing requirements of section 6033. Except for a paragraph numbering change contained in a cross-reference, §1.6033-2(g)(1)(vii) is unchanged by these final regulations.

Several commentators have suggested that expanded definitions of certain terms used in the internal support test be included in this Treasury decision. The final regulations do not incorporate this suggestion. The IRS and the Treasury Department intend for these final regulations to reissue the test published in Rev. Proc. 86-23 as the new definition for an integrated auxiliary of a church. If guidance is necessary on the application of the definition to specific cases, that guidance is more appropriately provided in non-regulatory form, such as through private letter rulings or revenue rulings.

The amendment to §1.6033-2(g)(5) is effective with respect to returns filed for taxable years beginning after December 31, 1969. However, for returns filed for taxable years beginning after December 31, 1969, but before December 20, 1995, the exclusively religious test contained in §1.6033-2(g)(5) prior to its amendment by these final regulations may, at the entity's option, be used as an alternative to the financial support test in determining whether an entity is an integrated auxiliary of a

church. The remainder of the amendments are effective with respect to returns for taxable years beginning after December 31, 1969. Therefore, for returns filed for taxable years beginning after December 20, 1995, the definition of integrated auxiliary of a church contained in §1.6033-2(h) will be used in determining whether an entity is an integrated auxiliary of a church.

Special Analyses

It has been determined that this Treasury decision is not a significant regulatory action as defined in EO 12866. Therefore, a regulatory assessment is not required. It has also been determined that section 553(b) of the Administrative Procedure Act (5 U.S.C. chapter 5) and the Regulatory Flexibility Act (5 U.S.C. chapter 6) do not apply to these regulations, and, therefore, Regulatory Flexibility Analysis is not required. Pursuant to section 7805(f) of the Internal Revenue Code, the notice of proposed rulemaking preceding these regulations was submitted to the Chief Counsel for Advocacy of the Small Business Administration for comment on its impact on small business.

Drafting Information

The principal author of this Treasury decision is Terri Harris, Office of the Associate Chief Counsel (Employee Benefits and Exempt Organizations), IRS. However, personnel from other offices of the IRS and the Treasury Department participated in their development.

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Adoption of Amendments to the Regulations

Accordingly, 26 CFR part 1 is amended as follows:

PART 1—INCOME TAXES

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

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

Par. 2. Section 1.508-1 is amended by revising paragraphs (a)(3)(i) introductory text and (a)(3)(i)(a) to read as follows:

§1.508-1 Notices.

(a) * * *

(3) * * * (i) Paragraphs (a)(1) and (2) of this section are inapplicable to the following organizations:

(a) Churches, interchurch organizations of local units of a church, conventions or associations of churches, or integrated auxiliaries of a church. See §1.6033-2(h) regarding the definition of integrated auxiliary of a church;

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Par. 3. Section 1.6033-2 is amended as follows:

1. Paragraphs (g)(1)(i) and (g)(vii) are revised.

2. Paragraph (g)(5) is removed and reserved.

3. Paragraphs (h) through (j) are redesignated as paragraphs (i) through (k).

4. New paragraph (h) is added.

The added and revised provisions read as follows:

§1.6033-2 Returns by exempt organizations (taxable years beginning after December 31, 1969) and returns by certain nonexempt organizations (taxable years beginning after December 31, 1980).

* * * * *

(g) * * *

(1) * * *

(i) A church, an interchurch organization of local units of a church, a convention or association of churches, or an integrated auxiliary of a church (as defined in paragraph (h) of this section);

* * * * *

(vii) An educational organization (below college level) that is described in section 170(b)(1)(A)(ii), that has a program of a general academic nature, and that is affiliated (within the meaning of paragraph (h)(2) of this section) with a church or operated by a religious order.

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(h) *Integrated auxiliary*—(1) *In general.* For purposes of this title, the term *integrated auxiliary of a church* means an organization that is—

(i) Described both in sections 501(c)(3) and 509(a)(1), (2), or (3);

(ii) Affiliated with a church or a convention or association of churches; and

(iii) Internally supported.

(2) *Affiliation.* An organization is affiliated with a church or a convention or association of churches, for purposes of paragraph (h)(1)(ii) of this section, if—

(i) The organization is covered by a group exemption letter issued under applicable administrative procedures, (such as Rev. Proc. 80-27 (1980-1 C.B. 677); See §601.601(a)(2)(ii)(b)), to a church or a convention or association of churches;

(ii) The organization is operated, supervised, or controlled by or in connection with (as defined in §1.509(a)-4) a church or a convention or association of churches; or

(iii) Relevant facts and circumstances show that it is so affiliated.

(3) *Facts and circumstances.* For purposes of paragraph (h)(2)(iii) of this section, relevant facts and circumstances that indicate an organization is affiliated with a church or a convention or association of churches include the following factors. However, the absence of one or more of the following factors does not necessarily preclude classification of an organization as being affiliated with a church or a convention or association of churches—

(i) The organization's enabling instrument (corporate charter, trust instrument, articles of association, constitution or similar document) or by-laws affirm that the organization shares common religious doctrines, principles, disciplines, or practices with a church or a convention or association of churches;

(ii) A church or a convention or association of churches has the authority to appoint or remove, or to control the appointment or removal of, at least one of the organization's officers or directors;

(iii) The corporate name of the organization indicates an institutional relationship with a church or a convention or association of churches;

(iv) The organization reports at least annually on its financial and general operations to a church or a convention or association of churches;

(v) An institutional relationship between the organization and a church or a convention or association of churches is affirmed by the church, or convention or association of churches, or a designee thereof; and

(vi) In the event of dissolution, the organization's assets are required to be distributed to a church or a convention or association of churches, or to an affiliate thereof within the meaning of this paragraph (h).

(4) *Internal support.* An organization is internally supported, for purposes of paragraph (h)(1)(iii) of this section, unless it both—

(i) Offers admissions, goods, services or facilities for sale, other than on an incidental basis, to the general public (except goods, services, or facilities sold at a nominal charge or for an insubstantial portion of the cost); and

(ii) Normally receives more than 50 percent of its support from a combination of governmental sources, public solicitation of contributions, and receipts from the sale of admissions, goods, performance of services, or furnishing of facilities in activities that are not unrelated trades or businesses.

(5) *Special rule.* Men's and women's organizations, seminaries, mission societies, and youth groups that satisfy paragraphs (h)(1)(i) and (ii) of this section are integrated auxiliaries of a church regardless of whether such an organization meets the internal support requirement under paragraph (h)(1)(iii) of this section.

(6) *Effective date.* This paragraph (h) applies for returns filed for taxable years beginning after December 31, 1969. For returns filed for taxable years beginning after December 31, 1969 but beginning before December 20, 1995, the definition for the term *integrated auxiliary of a church* set forth in §1.6033-2(g)(5) (as contained in the 26 CFR edition revised as of April 1, 1995) may be used as an alternative definition to such term set forth in this paragraph (h).

(7) *Examples of internal support.* The internal support test of this paragraph (h) is illustrated by the following examples, in each of which it is assumed that the organization's provision of goods and services does not constitute an unrelated trade or business:

Example 1. Organization A is described in sections 501(c)(3) and 509(a)(2) and is affiliated (within the meaning of this paragraph (h)) with a church. Organization A publishes a weekly newspaper as its only activity. On an incidental basis, some copies of Organization A's publication are sold to nonmembers of the church with which it is affiliated. Organization A advertises for subscriptions at places of worship of the church. Organization A is internally supported,

regardless of its sources of financial support, because it does not offer admissions, goods, services, or facilities for sale, other than on an incidental basis, to the general public. Organization A is an integrated auxiliary.

Example 2. Organization B is a retirement home described in sections 501(c)(3) and 509(a)(2). Organization B is affiliated (within the meaning of this paragraph (h)) with a church. Admission to Organization B is open to all members of the community for a fee. Organization B advertises in publications of general distribution appealing to the elderly and maintains its name on non-denominational listings of available retirement homes. Therefore, Organization B offers its services for sale to the general public on more than an incidental basis. Organization B receives a cash contribution of \$50,000 annually from the church. Fees received by Organization B from its residents total \$100,000 annually. Organization B does not receive any government support or contributions from the general public. Total support is \$150,000 (\$100,000 + \$50,000), and \$100,000 of that total is from receipts from the performance of services (66-2/3% of total support). Therefore, Organization B receives more than 50 percent of its support from receipts from the performance of services. Organization B is not internally supported and is not an integrated auxiliary.

Example 3. Organization C is a hospital that is described in sections 501(c)(3) and 509(a)(1). Organization C is affiliated (within the meaning of this paragraph (h)) with a church. Organization C is open to all persons in need of hospital care in the community, although most of Organization C's patients are members of the same denomination as the church with which Organization C is affiliated. Organization C maintains its name on hospital listings used by the general public, and participating doctors are allowed to admit all patients. Therefore, Organization C offers its services for sale to the general public on more than an incidental basis. Organization C annually receives \$250,000 in support from the church, \$1,000,000 in payments from patients and third party payors (including Medicare, Medicaid and other insurers) for patient care, \$100,000 in contributions from the public, \$100,000 in grants from the federal government (other than Medicare and Medicaid payments) and \$50,000 in investment income. Total support is \$1,500,000 (\$250,000 + \$1,000,000 + \$100,000 + \$100,000 + \$50,000), and \$1,200,000 (\$1,000,000 + \$100,000 + \$100,000) of that total is support from receipts from the performance of services, government sources, and public contributions (80% of total support). Therefore, Organization C receives more than 50 percent of its support from receipts from the performance of services, government sources, and public contributions. Organization C is not internally supported and is not an integrated auxiliary.

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Margaret Milner Richardson,
*Commissioner of
Internal Revenue.*

Approved November 27, 1995.

Leslie Samuels,
*Assistant Secretary of
the Treasury.*