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GENESIS AND ANALYSIS OF “INTEGRATED AUXILIARY” REGULATION

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Mr. Tobin:

My name is Charles Tobin and I'm from Albany, New York, and I've been asked to chair this portion of the program. It's my special privilege to introduce to you today an old friend of every one of you. George Reed has been a personal friend of mine for many years, and a person with whom I have consulted and sought help on many occasions in many areas of church concern. But most particularly in the area of taxation. And for this reason we are particularly fortunate to have George with us in these days when we are so deeply immersed in the problems of federal tax questions. So George, will you take it on from here?

Mr. Reed:

Thank you very much, Charlie. In the interest of conserving time, we will have the question and answer period after the next speaker, for what I have to say is a prelude to the address of Mr. Myers.

One of the most important aspects of tax law affecting the Catholic Church and most churches involves the definition of the term “church” and the term “integrated auxiliary of a church.” The definition of these terms has a very specific relationship to many broad areas of the law, such as unrelated business, pension reform legislation, the submission of financial returns (Form 990), and, as Jim Robinson explained to you yesterday, the term “integrated auxiliaries of a church” is now being used in legislation which will determine whether a nonprofit organization is engaged in excessive legislative activity.

There is a long history of the definition of the term “church.” The history of the definition of “integrated auxiliary of a church” is not extensive, but there has been quite a bit of activity involved in this area since 1969.

I'm sure most of you recall that before 1969 we had no problem with respect to filing financial returns. All nonprofit organizations operated, supervised or controlled by or in connection with a church were exempt from filing Form 990-A or 990. In the Tax Reform Legislation of 1969, the House Ways and Means Committee, at the very last moment, eliminated this exemption and would have subjected all nonprofit institutions, including churches, to a requirement of filing financial returns.

The USCC, together with the National Council of Churches, submitted a strong statement in the Senate, with the result that the Senate Finance Committee amended Section 6033 to provide a mandatory exemption for churches, conventions of churches, and associations of churches. Senator Bennett of Utah, a prominent member of the Finance Committee, felt that this did not provide sufficient protection for church organizations, because Treasury had for a very long time adopted

a very narrow interpretation of the term "church." Accordingly, he introduced an amendment which was adopted by the committee. It provided for the mandatory exemption of "auxiliaries of a church." This is the way it was introduced. Then, eventually, it was amended in the Conference Committee to include "integrated auxiliaries of a church." So the legislation ultimately provided for a mandatory exclusion for "churches" and "integrated auxiliaries of churches." Fragmentary legislative history indicated that the term "integrated auxiliary" included the church's religious school, youth groups, men's and women's clubs, mission societies, and interchurch organizations of local units.

Because there was no definition of the term "church" and no meaningful definition of the term "integrated auxiliary" by Treasury, all organizations that were covered by a Group Ruling extended to a church were exempted each year from filing Form 990. This was a specific exercise of discretion by the Secretary of the Treasury. This situation prevailed from 1969 until 1975. At that time it was announced that there would be no more exemptions because there would be a definition of the term "integrated auxiliary." On February 11 of this year a Notice of Rulemaking was filed in the Federal Register, endeavoring to define the term "integrated auxiliary of a church." It reads as follows:

"An integrated auxiliary of a church means an organization described in Section 501(c)(3) whose primary purpose is to carry out the tenets, functions and principles of the faith of the church with which it is affiliated, whose operations in implementing such primary purpose directly promote religious activity among the members of the Church. Organizations considered to be integrated auxiliaries include men's and women's clubs, mission societies and religious schools. Schools of a general academic or vocational nature are not considered to be integrated auxiliaries, even though they have a religious environment or promote the Church's teachings."

Then in the next paragraph of the definition IRS states that for the purposes of this paragraph the term "affiliated" means either controlled by or associated with a church. Then Treasury proceeded to give a series of examples implementing this definition. For example, it was held that a religious seminary would be considered an integrated auxiliary, but that a hospital, an orphanage, a home for the elderly, or a school that had a legal identity separate from the Church would not be considered an integrated auxiliary. None of these categories of traditional church operations would be considered to be within the meaning of the term "integrated auxiliary." The specific reason given was that all these organizations help the community and not the members of the Church. In short, IRS took the position that in order to be an integrated auxiliary, the activity of the auxiliary had to be exclusively limited to helping the members of the Church itself. If you help the community, this places you in the same position as any other charitable organization; consequently, you are not entitled to the protection of the law.

There has been a very vigorous response. We were given until March 29 in which to file comments. Eighty-one comments were filed by March 29, all of which opposed the definition of the term "integrated auxiliary of a church." The USCC, after consulting representatives of religious orders, the Catholic Hospital Association, the National Conference of Charities, the National Catholic Education Organization, and other groups, filed a protest in behalf of the institutional system of the Catholic Church.

Initially, we filed a statement saying that this whole issue would take a long time to resolve, so, there should be a period of grace, especially for those organizations which have to file by May 15 for the taxable year of 1975. Secondly, in addition in many other arguments, we suggested that the whole position of Treasury be taken back to the drawing board, restudied and a period of grace be extended for the whole year.

In our principal response we contended that the proposed regulation in an effort to define the term "integrated auxiliary of a church" actually purports to define that term, plus the term "church". It partially defines the term "church" negatively, by excluding major seminaries, certain elementary and secondary schools, orphanages, hospitals and homes for the aged. In this respect, we contended that Treasury exceeded the intent of Congress by requiring essential Church organizations to file. Now, we know from our experience in 1969 that Congress definitely intended to provide broad protection for a church and a broad protection for church organizations, including integrated auxiliaries. With the situation presented to us, in the Notice of Rulemaking, we have the mandatory exemption for a church, which is being progressively defined in a limited manner, and then you have these peripheral organizations, like men's organizations, and women's organizations, which are given the status of integrated auxiliaries. And in between the two there's no protection at all. This is absurd. Congress never intended to give maximum protection to these peripheral organizations and not to agencies which have been carrying out the mission of the Church for centuries. And we emphasized this very strongly.

We further argued that the regulations should not, under any circumstances, adopt the functional test contained in the present proposed regulations, nor use any language which directly or indirectly attempted to revive the sacerdotal test. In that connection you must remember that in 1970 when Regulation 170 was published, it contained a definition of the term "church" which embraced the old sacerdotal test. We objected strongly to that approach. We developed a definition of the terms "church" and "integrated auxiliaries". We had a conference with five top men in Treasury and presented our definition. Among other things, we indicated that a church would include all the administrative agencies of the church, cemeteries, and religious orders. Further, we submitted that other organizations like hospitals, and homes for the aged, should at least be defined as integrated auxiliaries. This was presented to Treasury in full conference. At the conclusion of the conference the chairman asked every man around the table whether they agreed with our position, and they all said yes. The difficulty is that within six months all these officials have left the Treasury. So we're still trying to come up with a definition of the term "church" and from what Mr. Lurie said yesterday, you know we haven't come much closer. So the term "integrated auxiliaries" was involved in that definition and it was tentatively accepted. Unfortunately, the current Notice of Rulemaking involves the same proposition which was rejected in 1970.

Now, what about the response of the various groups. It's a very interesting response, and I'm sure it's going to be effective. I think every significant Baptist group in the country filed, including the National Baptist Conference. Essentially, they said the proposed regulation violates separation of church and state. They said it should be withdrawn, and IRS should decide filing requirements on a case by case basis. This might be the most practical suggestion of all.

The Seventh Day Adventists were very concerned. They opposed the Notice of Rulemaking proposal very strongly. They suggested that the definition read as follows:

“An organization described in Section 501(c)(3) which promotes religious activity and one of whose principal purposes is to carry out the tenet, function, and principles of faith of the church with which it is affiliated.”

The Seventh Day Adventists further indicated that under this language a hospital owned by a church, or a school owned by a church would not be required to file.

The Lutheran Church took the position that the definition fails to recognize the integrity of church structures, and unconstitutionally represents the judgment of IRS on what a church should be. Moreover, it denies the social mission of the Church. This concept ran through most of the 81 Comments.

The response of the Mormon Church is very interesting, because it was submitted by the attorney for the Mormon Church who was deeply involved in the formulation of the whole term “integrated auxiliary.” Mr. Bennett is from Utah. Accordingly, it is fair to assume that the attorney for the Mormon Church knew precisely what the Senator had in mind when he introduced his amendment. He strongly opposed and very severely criticized the interpretation on the ground that it does not reflect Congressional intent. Among other things, counsel for the Mormon Church criticizes the limitation to the provision of religious activity among members of the church. The Mormons stated that they would be comfortable with the definition of the term “church” which reads as follows:

“An organization described in 501(c)(3) whose primary purpose is to carry out the tenets, functions, and principles of faith of the church with which it is affiliated.”

I doubt whether the Baptists would accept this approach because they wouldn't want the Federal Government to determine what is or is not the primary purpose. I don't think we would, either. Actually, the term “primary purpose” as used in unrelated business was dropped in a regulation a few years ago and IRS inserted the term “contributes importantly.” Possibly language such as “an organization which contributes importantly to carrying out the tenets, functions and principles of the faith of the church with which it is affiliated” would be helpful. However, I think that Treasury should go back to some of the statements Congress has made with respect to the whole issue. In 1954, the Senate Finance Report after we'd testified before the Senate and placed before the Senate the whole canon law with respect to our church structure, came up with this statement:

“Your committee understands that the church, to some denominations includes religious orders, as well as other organizations which as integral parts of the church, are engaged in carrying out the function of the church, whether as separate corporations, or otherwise. Your committee understands that the church includes organizations which as integral parts of the church are engaging in carrying out the functions of the church, whether as separate corporations or otherwise.”

I think that if IRS and Treasury would examine this position, it would have a strong Congressional basis for resolving this difficulty.

What about some of the neutral sources? Like the American Bar Association.

It did not have time to adopt a formal resolution, but as you know the American Bar Association is divided into various sections, and what they apparently did was send a questionnaire to their Exempt Organizations Section, and the Administrative and Practice Section. The responses are interesting. They totaled the responses, and essentially the responses of these two sections are that caring for the sick would qualify as an integrated auxiliary, provided that there is a close relationship between a hospital and a church. With respect to that point, the responses said "certainly, some hospitals carry religious names in their titles, but are completely separated from the religious organization and those hospitals should not qualify." On the same point, comments were submitted by individual members of the committee on Administrative Practice. These individuals questioned why a hospital of the nature set forth in Example 2 of the proposed regulation even though it may not be separately incorporated, or even though it is separately incorporated, should not be regarded, as an integrated auxiliary, where the hospital is materially supported, both financially and from the point of view of its central administration and important staffing, by a church organization. These responses mentioned the Catholic hospitals. *Both sections stated that they could see no reason why parochial schools should be excluded from the definition.*

Additionally, they observed that the position on schools is directly contrary to that taken by the Supreme Court of the United States in its various decisions.

Now, what is the current status of this particular ruling? On April 27 the Internal Revenue Service issued an announcement in the Federal Register, indicating that a public hearing would be held on this regulation on June 7. It further stated that, since regulations relating to integrated auxiliaries have not yet been finalized, it was found desirable to delay the filing requirement for subordinate organizations of churches, pending a public hearing. But then, this announcement concluded with this statement: "Subordinate organizations covered by a group exemption issued to a church central or parent organization will not be required to file a 1975 Form 990."

There was considerable confusion in the field. What did this mean? Was it a temporary period of grace or did it apply to the year 1975? We checked around and found the man who wrote this particular announcement, and who was responsible for the decision. We asked him what it meant. He said, "You should know, it's a direct response to your request." Accordingly, in our opinion, this is an exemption for the taxable year of '75.

On May 21 we must file an outline of our remarks which we will make on June 7. I know from other addresses which I have heard by Treasury officials within the last week that they are going to take a hard line, they are going to endeavor to adhere to everything that was stated in this particular Notice of Rulemaking, with the possible exception of schools. I think there is some reason to believe that they might change their position on parochial schools. They published an announcement last week that a separate certification form is being developed for use by private schools which are not required to file Form 990. If they are doing that, then this is a clear indication that some schools, many schools, hopefully, will not be required to file. This is the history of this particular controversy, and I emphasize the term controversy because I expect that it will be similar to the controversy we had in 1954, when there was an attempt to define the term "church" in the context of the whole Christian Brothers experience.