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Mail-Order Ministries under the Section 170 Charitable Contribution Deduction: The First Amendment Restrictions, the Minister's Burden of Proof, and the Effect of TRA '86

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### I. INTRODUCTION

Our tax system continues to lose revenue through a tax evasion device known as the "mail-order ministry." The device has proliferated over the years and now presents a major problem to the integrity of our revenue raising system. In attempting to challenge the tax-exempt status of a mail-order ministry, the Internal Revenue Service ("IRS") and the courts have had to deal with troublesome constitutional restrictions which arise in connection with the charitable contribution rules of section 170 of the Internal Revenue Code ("Code") and the religious purpose exemption of section 501(c)(3) of the Code.

The IRS refers to a mail-order ministry as a "tax protestor scheme" in which numerous groups sell church charters and minister’s credentials as part of a program which is designed to decrease a person’s income taxes.\(^1\) A typical plan involves promoters selling certificates of “ordination” through the mail, in exchange for a donation.\(^2\) Once ordained, the minister can establish an organization which can claim to be a church or other religious institution.\(^3\) Typically, a mail-order minister earns his or her living as something other than a minister.

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In general, a mail-order minister can avoid taxation by two methods. First, section 170 allows an individual, itemizing taxpayer to deduct a contribution to a church in an amount which does not exceed fifty percent of such individual's adjusted gross income. The church, in turn, provides the person with a home and living expenses. The second method requires the individual to take a "vow of poverty" and assign his or her assets and income derived from present employment to a church. The assigned income then provides for his or her living expenses. Typically, both plans are used together to cause tax avoidance. Thus, through either alternative, a mail-order minister is able to claim a tax-free return of a substantial portion of such individual's outside business income.

This article will concern the "section 170 deduction method" of establishing a mail-order ministry. Part II examines the constitutional restraints that present problems to the IRS and the courts when they attempt to challenge this tax avoidance scheme. Part III sets forth the problems that the IRS and the courts face with mail-order ministry schemes. Part IV discusses the section 170 deduc-

4. A method of avoiding taxes through the utilization of a mail-order ministry, which is not often utilized, requires that the mail-order ministry receive a tax exemption by claiming that income earned by assets held in its name is not subject to tax. See Note, "I Know it When I See it": Mail-order Ministry Tax Fraud and the Problem of a Constitutionally Acceptable Definition of Religion, 25 AMER. CRIM. L. REV. 113 (1987) [hereinafter cited as Tax Fraud].

5. For itemizing taxpayers, contributions made to a "church or a convention or association of churches and to other publicly supported religious institutions qualify for deductions in an amount which is not in excess of 50 percent of the taxpayer's contribution base for a taxable year." I.R.C. § 170(b)(1)(A) (1988).


7. Id. (A salary paid for the services of a religious order member are attributable to the order's income, not to the member's income). Rev. Rul. 77-290, 1977-2 C.B. 26 (1977).


10. For discussions of the vow of poverty method of establishing a mail-order ministry See The Religious Purpose Exemption Under the First Amendment, supra note 9; Comment, Mail Order Ministries, The Religious Purpose Exemption and the Constitution, 33 No. 3 TAX LAW 959 (1980) [hereinafter cited as The Religious Purpose Exemption and the Constitution].
tion method. Finally, Part V provides a summary and conclusion of the article.

II. THE CONSTITUTIONAL RESTRAINTS

The first amendment to the United States Constitution provides that "Congress shall make no law respecting an establishment of religion, or prohibiting the free exercise thereof . . . ." This quote sets forth what are known as the "establishment" and "free exercise" clauses. The religious clauses generally have three goals: first, to ensure that any religious participation is voluntary; second, to keep state and religious affairs separate from each other; and third, to prevent the state from preferring one religion over another and from discriminating between one religion over another and from discriminating between religion and non-religion. These clauses set out the relationship between religion and government by imposing restrictions on the government and the courts when challenging the validity of mail-order ministry schemes.

A. The Establishment Clause

The establishment clause prohibits two things: first, government sponsorship of religion by mandating that government neither formally establish nor aid a religion; and second, a preference for religion over non-religion. The clause applies to both federal and local government.

The Supreme Court has set the boundaries of allowable governmental support for activities conducted by churches. The Court gradually developed a test which appeared in final form in Lemon v. Kurtzman. Under the Lemon test, a government act must have a secular legislative purpose and a primary effect which neither advances nor inhibits religion; and it must not have the effect of fostering excessive governmental entanglement in religion. Despite the Lemon test, the government may aid all people in a religiously neutral manner for secular purposes even though there is also some

11. U.S. Const. amend. I.
14. Id.
15. 403 U.S. 602 (1971).
16. Id. at 612-613. (citing Board of Education v. Allen, 392 U.S. 236, 243 (1968); Walz v. Tax Commissioner, 397 U.S. 664, 674 (1970)).
incidental aid to religious institutions.\textsuperscript{17}

\textbf{B. The Free Exercise Clause}

The free exercise clause forbids governmental interference with the right of religious belief.\textsuperscript{18} The Supreme Court has traditionally recognized that the clause absolutely forbids government interference with religious beliefs.\textsuperscript{19}

The important boundaries of the free exercise clause are set forth in three Supreme Court cases: \textit{Braunfeld v. Brown},\textsuperscript{20} \textit{Sherbert v. Verner},\textsuperscript{21} and \textit{Wisconsin v. Yoder}.\textsuperscript{22} In \textit{Braunfeld}, the Supreme Court held that a Pennsylvania statute, which limited business activity on Sunday, could constitutionally be applied to Orthodox Jews whose beliefs required them to observe another day as the Sabbath.\textsuperscript{23} The Supreme Court decided that even where the effect and purpose of a state statute is secular, if an individual burden on religion occurs, the law must be struck if the state can “accomplish its purpose by means which do not impose such a burden.”\textsuperscript{24} The Court stated that the free exercise clause does not forbid an incidental burden on the free exercise of religion, but, the government must show there are no less-restrictive alternative forms of regulation.\textsuperscript{25}

In \textit{Sherbert}, the Supreme Court held that state unemployment benefits could not be refused to a Seventh Day Adventist because she would not work on Saturday due to her religious convictions.\textsuperscript{26} The majority stated that for the refusal of benefits to withstand a free exercise challenge, “it must be either because her disqualification as a beneficiary represents no infringement by the state of her constitutional right of free exercise, or because an incidental burden on the free exercise of appellant’s religion may be

\begin{itemize}
\item \textsuperscript{17} See supra note 13 at 1031.
\item \textsuperscript{18} See supra note 9 at 898.
\item \textsuperscript{20} 366 U.S. 599 (1961).
\item \textsuperscript{21} 374 U.S. 398 (1963).
\item \textsuperscript{22} 406 U.S. 205 (1972).
\item \textsuperscript{23} 366 U.S. 599, 609 (1961).
\item \textsuperscript{24} \textit{Id.} at 607.
\item \textsuperscript{25} \textit{Id.}
\item \textsuperscript{26} 374 U.S. 398.
\end{itemize}
justified by a compelling state interest in the regulation . . . ." 27 This statement implies that the burden on the exercise of one’s religion is to be balanced against the state interest at issue and the degree in which the state interest would be undermined by accommodating the religious exercise. 28

Finally, in Yoder, the Supreme Court held that Wisconsin could not compel members of the Amish church to send their children to public school beyond the eighth grade. 29 The Supreme Court stated that in order for the state to succeed against a free exercise claim, "it must appear either that the state does not deny the free exercise of religious belief by its requirement, or that there is a state interest of sufficient magnitude to override the interest claiming protection under the Free Exercise Clause." 30 Thus, the Supreme Court followed Sherbert and Braunfeld because they require the state interest at issue to be balanced against the interest of the individual to freely practice his or her religion.

C. Religion and the Internal Revenue Laws

A constitutional issue which arises in mail-order ministry cases is whether the "church" is "organized" and "operated" for a religious purpose. 31 Under section 170, a charitable contribution
means a contribution or gift for the use of a corporation, trust or community chest, fund or foundation which is "organized" and "operated" exclusively for a "religious purpose." A taxpayer must make a charitable contribution before he or she can claim a tax deduction. However, section 170 and the regulations promulgated thereunder do not define how organizations are organized and operated exclusively for a religious purpose. However, section 501(c)(3) provides that organizations will be exempt from taxation if they are "organized and operated exclusively for religious . . . purposes." Treasury Regulation section 1.501(c)(3)-1 provides an explanation of how organizations are organized and operated exclusively for a religious purpose. This regulation promotes the common Congressional purpose of both section 170 and section 501, by providing guidance for the proper interpretation of section 170, although the regulation does not specifically refer to section 170. Thus, the rules set forth in the regulations under section 501(c)(3) guide the courts and the IRS in claims for deductions under section 170.

Section 1.501(c)(3)-1 does not define the term "religious purpose." In addition, the Code and Treasury regulations do not define the term "religion." The courts and the IRS have tried to define the word with little success. Thus, the term religion, as it is used in the "religious purpose" phrase of section 501(c)(3) and section 170(c) of the Code is not clearly defined. In addition to the problems incurred in defining a religious purpose under the first amendment, the courts and the IRS cannot question the sincerity of any other facts and circumstances which may bear upon the organization's claim for church status.

The Religious Purpose Exemption Under the First Amendment, supra note 9, at 918 n. 142.

34. Treas. Reg. § 1.501(c)(3)-1(a), (b) and (c), (as amended in 1976).
36. Calvin, 69 T.C. at 773.
38. See Procedures in 'Mail Order Ministries' Examinations, 4 Internal Revenue Manual (CCH) paragraph 7(10)75.5 (Mar. 17, 1988).
39. See, e.g., The Religious Purpose Exemption under the First Amendment, supra note 9.
of one's beliefs.\textsuperscript{40} Thus, they have problems determining whether an organization is in fact religious. As a result of this prohibition set forth by the first amendment, a window of opportunity under the guise of the first amendment has opened for mail-order ministry schemes.\textsuperscript{41} These so-called "churches" often claim that their members follow a "sincere" belief in a religion to meet the requirements under sections 170 and 501(c)(3) which shield their donors from required tax payments. Since problems exist with defining the term religion and determining whether an organization is in fact religious, it is difficult for the courts and the IRS to ascertain whether an institution is organized and operated for a religious purpose. The case of \textit{Universal Life Church v. United States},\textsuperscript{42} demonstrates the problems that the IRS and the courts face in this area.

III. \textbf{The Problems that the IRS and the Courts Face with Mail-Order Ministry Schemes}

In \textit{Universal Life Church, Inc. v. United States},\textsuperscript{43} the Universal Life Church ("ULC") ordained ministers, granted church charters, and issued Honorary Doctor of Divinity degrees.\textsuperscript{44} Requests for the ministers' credentials and church charters were made largely by mail. The church conferred free ministers' credentials to anyone who requested them.\textsuperscript{45} At trial, the founder of the church, Reverend Kirby J. Hensley, testified that "[t]he Universal Life Church has no traditional doctrine. It only believes in that which is right. We believe that everyone has a right to express it, and we recognize everyone's belief."\textsuperscript{46}

\textsuperscript{40} U.S. Const. amend. I.
\textsuperscript{41} For example, the IRS Manual provides that an organization will be considered "religious" only if its members have a sincere and meaningful belief in whatever doctrine is espoused, and this belief occupies in the lives of those members a place parallel to that filled by God in the lives of traditionally religious persons. \textit{See, e.g., The Religious Purpose Exemption under the First Amendment, supra note 9.} However, the Manual acknowledges that under the first amendment, the government cannot consider the content or sources of a doctrine which is alleged to constitute a particular religion and cannot make an attempt to evaluate the content of whatever doctrine a particular organization is religious. \textit{Id.}
\textsuperscript{43} \textit{Id.}
\textsuperscript{44} \textit{Id.}
\textsuperscript{45} Although the ULC did not require a fee as a condition to the issuance of minister's credentials, a free-will offering of twenty dollars was suggested. \textit{Id.}
\textsuperscript{46} \textit{Id.} at 773.
The government challenged the tax-exempt status of the ULC on the ground that the organization was not operated for a religious purpose and the issuance of Honorary Doctor of Divinity degrees by the ULC was in violation of public policy. The district court refused to accept the position of the government stating:

Neither this court nor any branch of government will consider the merits or fallacies of a religion. Nor will the court compare the beliefs, dogmas and practices of a newly organized religion with those of an older, more established religion. Were the court to do so, it would impinge upon the guarantees of the first amendment.

The district court held for the ULC because holding otherwise would require a ruling on the merits of a religion thus violating the first amendment. It is interesting to note that in an interview after the court’s decision, Reverend Hensley stated that the church was deliberately designed to exploit a church’s tax-exempt status.

The holding of Universal Life Church can be analogized for section 170(c) purposes although this case was argued on section 501(c)(3) grounds. Since the IRS granted the ULC’s tax exemption, ministers of the church were allowed to claim charitable contribution deductions. This decision thwarted the efforts of the IRS to terminate mail-order ministries.

The government has utilized other approaches to eradicate the tax protester schemes at issue. For example, in Universal Life Church, Inc. v. United States ("ULC II"), the claims court granted summary judgment against the ULC. The case is a prime example of how the IRS is currently challenging the tax-exempt status of mail-order ministry schemes. In ULC II, the IRS revoked the tax-exempt status of the ULC on grounds that the ULC was being operated for the substantial nonexempt purpose of providing tax advice to its ministers. The tax advice, concerning methods for tax avoidance, was disseminated through articles in newsletters, textbooks, pamphlets, oral presentations, and other materials.

47. Id. at 775.
48. Id. at 776.
49. Id.
50. See supra note 10 at 962 n. 22 (citing “Mail Order Ministers,” 60 Minutes, CBS Television, September 26, 1976).
52. Id. at 568-569.
53. Id. at 570-579.
The ministry also authorized the Church of Universal Harmony to recruit members for the ULC. The Church of Universal Harmony sold charters to congregations whose members committed criminal fraud and conspiracy and who operated sex clubs, a discotheque, a restaurant and conducted other nonexempt activities. Moreover, an individual convicted of criminal tax fraud sat on the board of directors of the ULC. Finally, the ministry encouraged members to write correspondence to the IRS advocating against the disallowance of members’ deductions.

The claims court agreed with the IRS, and held that the ULC was operated for a substantial nonexempt purpose. The claims court found that the ministry’s dissemination of tax advice to its ministers was primarily to promote the substantial nonexempt purpose of “giving tax advice.” Moreover, the claims court found that the ULC’s affiliation with the Church of Universal Harmony and the activities of its recruits further evidenced that the church was operated for a substantial nonexempt purpose.

The facts in ULC II are markedly different than those found in the district court decision of Universal Life Church, Inc. v. United States (ULC I). Listed below are the pertinent facts in ULC II which differ from ULC I:

1. In ULC II the church issued newsletters, textbooks, pamphlets, manuals, oral presentations and other publications which contained tax advice aimed at avoiding taxes;
2. agents who were convicted of tax evasion provided recruits for the ULC;
3. charter churches operated sex stores, restaurants and, discotheques;
4. an individual convicted of criminal tax fraud sat on the ULC board of directors;
5. members without knowledge of the circumstances were encouraged to write letters to the IRS to protest against the denial of tax deductions to other members.

54. Id. at 578-579.
55. Id. at 584.
56. Id. at 574.
57. Id. at 584.
58. Id. at 582.
59. Id. at 584.
60. Id. at 580.
61. Id. at 570-584.
Thus, since the facts of the cases are substantially different, *ULC I* continues to have favorable precedential value for mail-order ministers who seek to abuse our tax system.

In addition to problems presented by the first amendment, detecting a mail-order ministry scheme is difficult. Section 508(c) of the Code does not require churches to apply to the government for recognition of their tax-exempt status. This means that such churches do not have to file a tax exemption form with the IRS.

IV. THE SECTION 170 DEDUCTION METHOD

A. Background

The creation of mail-order ministries under section 170 has been attacked by the IRS and the courts. These challenges have specifically focused on denying the mail-order minister's section 170 deduction.

The history of the charitable contribution deduction under section 170 began when the deduction was proposed during consideration of the Revenue Act of 1913. Supporters of the deduction claimed that "it is desirable that there should be no curtailment imposed by this act upon the benevolent members of the community." Although the deduction proposal was rejected, a charitable deduction was enacted in 1917, when the top marginal income tax rate dramatically increased to help pay for the United States' entry into World War I. The deduction was explicitly pro-

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65. See, Harrison v. Commissioner, 805 F.2d 973 (11th Cir. 1986); Smith v. Commissioner, 800 F.2d 973 (11th Cir. 1986).
68. See 55 Cong. Rec. 6728 (1917) (statement of Sen. Hollis). The Revenue Act of 1917, ch. 63 § 1201(2), 20 Stat. 300, 330, permitted a deduction for: contributions or gifts actually made within the year to corporations or associations organized and operated exclusively for religious, charitable, scientific or educational purposes, or . . . cruelty to children or animals, no part of the net income of which inures to the individual, to an amount not in excess of fifteen percentum of the taxpayer's taxable net income as computed without the benefit of this paragraph. Such contributions or gifts shall be allowable as deductions only if verified under rules and regulations prescribed by the Commissioner of Internal Revenue, with the approval of the Secretary of the Treasury.
moted as a method of decreasing the deterrent effect of higher income tax rate on charitable contributions.  

The scope of section 170 has expanded since its adoption. For example, the deduction was extended to corporations in 1953. In addition, most of the complexities and refinements of the current statute were added as anti-abuse measures by the Tax Reform Act of 1969.

Section 170(a) of the Code in part provides a deduction to itemizing taxpayers for certain types of “charitable contributions.” The term “charitable contribution” is defined in pertinent part as a “contribution or gift to or for the use of . . . [a] corporation, trust, or community chest, fund, or foundation organized and operated exclusively for . . . religious purposes.” In addition, no part of the net earnings of one of the aforementioned entities may inure to the benefit of any private shareholder or person. A “qualifying” charitable entity can lose a tax exemption for attempting to influence legislation. Also, a charitable entity cannot participate in or intervene in any political campaign on behalf of any candidate for public office. A taxpayer’s charitable contribution deduction is generally limited to an exemption equal to fifty percent of adjusted gross income for total gifts of cash and/or

One legislator, who articulated the problem the deduction was aimed at solving, stated:

Usually people contribute to charities and educational objects out of their surplus. After they have done everything else they want to do, after they have educated their children and traveled and spent their money on everything they really want or think they want, then if they have something left over, they will contribute it to a college or to the Red Cross or for some scientific purposes. Now, when war comes and we impose these very heavy taxes on income, that will be the first place where the wealthy men will be tempted to economize, namely, in donations to charity. They will say, “charity begins at home.”

73. I.R.C. § 170(c) (1988). See also supra note 35 and accompanying text.
short-term capital gain property; and thirty percent of adjusted gross income for total gifts of long-term capital gain property. 76

B. Defeating a Mail-Order Ministry Established Under the Section 170 Deduction Method

Courts have adopted a method of preventing tax avoidance which involves the determination of whether a taxpayer, including a mail-order minister, has met the burden of proof for claiming a charitable deduction. 77 If the IRS disallows a charitable deduction claim, the taxpayer bears the burden of demonstrating that he or she is entitled to the deduction. 78

A mail-order minister must meet several tests to satisfy the burden of proof. First, under section 170(c)(2)(C) of the Code, the charitable deduction must be claimed for the same taxable year in which the property is transferred. 79 In Stephenson v. Commissioner, 80 the petitioner received ministers' credentials and a church charter through the mail from the Life Science Church around February or early March of 1977. After receiving the church charter, the petitioner established the “Life Science Church of Allegan” and opened a bank account in the name of the church. 81 Subsequently, the petitioner deposited most of his earnings in the account of Life Science Church of Allegan. 82 In July of 1977, the petitioner and his wife placed the proceeds of the sale of their house into the church account. 83

The petitioner never obtained a tax exemption for contributions to the Life Science Church of Allegan under section

76. I.R.C. § 170(b)(1)(A)(i) (1988). A deduction for a contribution is generally limited to fifty percent of adjusted gross income if made to a section 170(b)(1)(A)(i)-(iv) organization. Presumably, mail order ministries would claim “church” status under section 170(b)(1)(A)(i). Taxpayers have an option with long-term capital gain property to deduct up to fifty percent adjusted gross income limit which is afforded cash and short-term capital gain property. I.R.C. § 170(b)(1)(C)(iii) (1988). To receive such a deduction, the taxpayer must reduce the amount of the gift by forty percent of the appreciation which has occurred on it. Id.

77. E.g., Deputy v. duPont, 308 U.S. 488 (1940).

78. Id.


81. Id. at 998.

82. Id.

83. Id.
On his 1976 tax return, the petitioner claimed charitable contribution deductions under section 170 for contributions to the church. In *Stephenson*, the Tax Court stated that section 170(a) allows a deduction for charitable contributions only if the payment is made during a time when a church is in existence. The court determined that Mr. Stephenson never contributed any money or other property to the Life Science Church or the Life Science Church of Allegan in 1976 because the checks written to the churches were actually written in February or early March, 1977. The checks issued by the petitioner were back-dated to December 30, 1976. For example, on the back of one check that was sent to a member of the Life Science Church as a contribution, a bank stamped the date of deposit as February 26, 1977. The Tax court also determined that other checks which were back-dated to December 30, 1976 were written in February or March, 1977. The petitioner failed to show that he created a church or contributed money into the name of either the Life Science Church or the Life Science Church of Allegan in 1976.

To obtain a charitable deduction under section 170, a mail-order minister must also prove that he or she has relinquished dominion and control over the property that was allegedly donated to his or her religious organization. In *Davis v. Commissioner*, petitioners, James J. Davis and Peggy Davis, husband and wife, attempted to claim charitable deductions for contributions to the ULC. Mrs. Davis obtained an honorary Doctor of Divinity “degree” and a Doctor of Universal Life “degree” from the ULC. The petitioners also obtained a charter from the ULC which created their own chapter of the church. Subsequently, Mrs. Davis became the sole signatory over two checking accounts that were opened in the name of the Universal Life Church and not the ULC

84. *Id.* at 999.
85. *Id.* at 1002.
86. *Id.* at 999.
87. *Id.*
88. *Id.*
89. *Id.*
90. *Id.*
92. *Id.* at 806.
93. *Id.* at 808-809.
94. *Id.* at 808.
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(whicn as mentioned above, stands for “Universal Life Church, Inc.”). The petitioners later bought a condominium in Florida and paid part of their mortgage payments along with other personal expenses with checks drawn from the Universal Life Church accounts.

The Tax Court first noted that deductions are a matter of legislative grace and that taxpayers must meet specific requirements for the deductions they claim. The court subsequently held that no charitable deductions could be taken because Mrs. Davis failed to relinquish dominion and control over her Universal Life Church checking accounts. The Tax Court stated that the term “charitable contribution” as it is employed in section 170, is largely synonymous with the word “gift.” The Davis court stated that a gift is generally defined as “a voluntary transfer of property to another without consideration.” The court concluded that since the petitioners retained control over the checking accounts, no gift was made. Undoubtedly, the Tax Court ruled that since Mrs. Davis was the sole signatory over a checking account in the name of an entity which only the petitioners were members, no “transfer” was ever made. Therefore, the court found that dominion and control was never relinquished.

A taxpayer must also have a charitable motive to contribute property before he or she can claim a charitable deduction. In Phil Poldrugovaz and Madeline Poldrugovaz, the petitioners, Phil and Madeline Poldrugovaz, husband and wife, each received a “certification of ordination” and a church “charter” from the Freedom Church of Revelation (“FCR”). The FCR required all individuals who wished to become ministers, to give a “donation” of ten

95. Id. at 809. See also supra note 43 and accompanying text.
96. Id. at 810-811.
97. Id. at 815. See also Deputy v. duPont, 308 U.S. 488 (1940); New Colonial Ice Co. v. Helvering, 292 U.S. 435 (1934).
98. Id. at 817.
99. Id. at 817. See also Seed v. Commissioner, 57 T.C. 265, 275 (1971); De Jong v. Commissioner, 36 T.C. 896, 899 (1961), aff’d, 309 F.2d 373, 376-379 (9th Cir. 1962).
100. Davis, 81 T.C. at 817.
101. Id. In addition, Kirby Hensly testified in an attempt to establish that the contributions had been made to ULC Modesto. The Court did not find his evidence credible. Thus, the deduction was denied.
102. E.g., People v. Life Science Church, 450 N.Y.S. 2d 664, 113 Misc. 2d 952 (1982).
percent of the individual's prior years' gross income.\textsuperscript{104} The petitioners delivered a check to FCR in the amount of $3,500.\textsuperscript{105} This "donation" represented approximately ten percent of the petitioners' prior year's gross income.\textsuperscript{106} The Poldrugovaz's transfer of $3,500 to the FCR was made in consideration for the petitioners' certificates of ordination and charter and the right to attend seminars taught by Freedom College, an institution affiliated with the church.\textsuperscript{107} The petitioners attended many of these seminars where they learned how to reduce their tax obligations by becoming ministers, establishing their own church, and deducting contributions. These contributions would eventually be used for personal expenses.\textsuperscript{108} Finally, during the tax year at issue, the petitioners made a charitable contribution totaling one hundred dollars to institutions not associated with FCR. The greatest single contribution to those institutions amounted to ten dollars.\textsuperscript{109}

The Tax Court held that although the petitioners transferred $3,500 to the FCR in the tax year at issue, they did not evidence that this transfer constituted a charitable contribution.\textsuperscript{110} The court, resting upon their position espoused in \textit{Davis}, held that a "charitable contribution" is largely synonymous with the word "gift."\textsuperscript{111} However, the \textit{Poldrugovaz} court added that if a payment is made for an expectation of more than the satisfaction of giving, such a payment is not a gift.\textsuperscript{112}

\begin{enumerate}
\item \textit{Id.} at 862.
\item \textit{Id.}
\item \textit{Id.}
\item \textit{Id.}
\item \textit{Id.}
\item \textit{Id.}
\item \textit{Id.}
\item \textit{Id.}
\item \textit{Id.}
\item \textit{Id.}
\item \textit{Id.} at 865.
\item \textit{Id.} \textit{See also} \textit{Davis v. Commissioner}, 81 T.C. 806 (1983).
\item \textit{Id.} \textit{See} \textit{De Jong v. Commissioner}, 36 T.C. at 899. \textit{See also} \textit{People v. Life Science Church}, 450 N.Y.S. 2d 664, 113 Misc. 2d 952 (1982) ("If the benefits that the transferor can reasonably expect to obtain by making the transfer are sufficiently substantiated to provide a 'quid pro quo,' no deduction under section 170 is allowed").
\item In \textit{Stubbs v. U.S.}, 428 F.2d 885, 887 (9th Cir. 1970), \textit{cert. denied}, 400 U.S. 1009 (1971), the taxpayers entered into a contract to buy land. The contract was contingent on whether the buyers could obtain rezoning to allow the use of a trailer court and shopping center. \textit{Id.} at 885. To insure access to the portion of the land intended for the mobile home development, the plat provided for the "donation" of a strip of property as a public road. \textit{Id.} The Ninth Circuit stated: The inquiry [into the motive behind the alleged charitable transfer] serves to expose the true nature of the transaction: that . . . the "gift"
This rule is supported by two policy considerations. First, a gift is different than an exchange because it is made out of a detached generosity without the thought of receiving something in return. Second, the rule deters a "gift" which inures to the benefit of the donor because the law is aimed at preventing individuals from making transfers with merely an inurement incentive. Finally, the court stated that the determination of a taxpayer's true incentive to make a transfer involved a factual inquiry.

Applying the above principles to the facts of the case, the Poldrugovaz court decided that the petitioners failed to demonstrate that the $3,500 they transferred to the FCR qualified as a charitable contribution. The court based its holding on its belief that the petitioners' transfer was made principally in expectation of specific economic benefits which would not otherwise have been available to them.

In reaching its conclusion, the Tax Court focused on two facts. First, the petitioners knew that in return for their transfer they would receive a significant tax deduction. For example, the court stated that the petitioners attended seminars where they were instructed on how to reduce their tax burden by establishing a ministry. Second, the Poldrugovaz court noted that the petitioners made no other single contribution in excess of ten dollars to any other charitable institution during the tax year at issue. A charitable motive is implied if the petitioners made no other transfers in amounts similar to the one that they were claiming as a deduction.

... was in expectation of the receipt of certain specified direct economic benefits within the power of the recipient to bestow directly or indirectly, which otherwise might not be forthcoming. 

Id. at 887. Thus, the court, in denying the taxpayers' claimed charitable deduction, stated that purpose of the transfer was to benefit the favorable zoning which would guarantee public access to the mobile home development. Id. See also Burwell v. Commissioner, 89 T.C. No. 41 (1987).

113. Id.
114. Id.
115. 47 T.C.M. at 865 (1974).
116. Id. at 865-866.
117. Id. at 865. (The court also found that no deduction should be allowed for certain property transferred to the local "chapter").
118. Id.
119. Id. (The Poldrugovaz court noted that these seminars instructed the petitioners on how they could use their ministry to, inter alia, decrease tax obligations by approximately seventy percent to one hundred percent after the ordination of the petitioners).
120. Id.
When a person's motive for transferring is determined by considering the amount of other transfers that the individual made within the same tax year, the determination is based on the individual's habit. In Poldrugovaz, it is reasonable to assume that the petitioners were in the habit of making charitable donations of ten dollars or less per contribution. Since the $3,500 transfer was so large in comparison to the other transfers, some evidence existed that the transfer at issue was made for other than charitable purposes.

In order to obtain a charitable deduction, a mail-order minister must also evidence that no part of the net earnings of the religious or charitable institution inure to the benefit of any private shareholder/individual. The courts and the IRS have experienced much success in using the inurement restriction to deny the claims of mail-order ministers for charitable contribution deductions. The inurement prohibition has been successful because it does not require inquiry into the sincerity of the claimant's religious beliefs.

In Page v. Commissioner, the petitioners, Douglas and Carolyn Page, husband and wife, sought to deduct transfers of money to Chapter 8035, a subsidiary of the Basic Bible Church of America ("Chapter 8035"). The petitioners completed pre-printed forms from the Basic Bible Church of America ("BBC"). The BBC provided bylaws and charter for Chapter 8035, certificates of ordination for the petitioners, statements about the status of Mr. and Mrs. Page as ministers, and a vow of poverty. The bylaws of Chapter 8035 stated in relevant part that: Mr. Page would be "head of the Chapter" for life; Mr. Page would have sole authority over the church; nonvoting trustees would be named by the Head of the Chapter; the trustees, which included Mr. Page's wife, would hold in trust all real and personal property of the chapter; and Mr. Page would have sole authority to control and disburse the church's funds and property for his family's and

121. Id.
123. See infra notes 124-140 and accompanying text.
125. Id.
126. Id. at 1353.
members' support.\textsuperscript{127}

Mr. and Mrs. Page converted a portion of their home into a chapel during the tax years at issue.\textsuperscript{128} The resulting structure contained two pews, a few chairs, and a pool table.\textsuperscript{129} The Page's used a church checking account to pay family bills.\textsuperscript{130} The petitioners claimed charitable contribution deductions on earnings they transferred into the church checking account.\textsuperscript{131} The Tax Court denied the petitioners' claimed deductions.\textsuperscript{132}

The Eighth Circuit Court of Appeals upheld the Tax Court's decision because the Page's failed to demonstrate that the church's net earnings did not inure to their benefit.\textsuperscript{133} Specifically, the appellate court held that Mr. Page retained and exercised control over all the property and money in the church account for personal living expenses.\textsuperscript{134}

The court of appeals stated that it was not questioning whether Chapter 8035 was a church or whether the members' practices constituted a religion.\textsuperscript{135} Thus, the inurement proscription has proved to be a strong and successful tactic for denying charitable deduction claims of mail-order ministers because its use does not violate the establishment or free exercise clauses of the first amendment.

The strength of the inurement provision to withstand constitutional scrutiny was also evidenced in \textit{McGahen v. Commissioner}.\textsuperscript{136} In this case Carl V. McGahen, the petitioner, was ordained a minister, received a doctor of divinity degree, and was chartered as a subsidiary of the BBC.\textsuperscript{137} Before and after Mr. McGahen's ordination, the petitioner worked as a boilermaker-welder for various corporations.\textsuperscript{138} Moreover, after petitioner's ordination, he was instructed by an archbishop of the BBC to con-
continue his occupation as a boilermaker-welder. The bylaws of the BBC subsidiary stated in pertinent part that: one, the petitioner held title to all real and personal property of the subsidiary; and two, the petitioner had sole power to control and dispense with the subsidiary's funds and property for his support. The petitioner put all of his earnings into a checking account in the subsidiary church of the BBC. During the tax years in issue, Mr. McGahen used the checking account to support his children, to pay mortgage installments on his house, his union dues, certain taxes, repair bills, gasoline, and insurance payments for his automobiles. The petitioner claimed charitable contribution deductions for the tax year earnings he transferred into the checking account for the BBC subsidiary.

The Tax Court denied Mr. McGahen's claimed charitable deductions in part because the court held that the petitioner received prohibited inurement. The court considered three facts in making its decision: first, the fact that the bylaws stated that the petitioner was to hold title to all real and personal property of the BBC subsidiary; second, the fact that the bylaws provided that Mr. McGahen had sole power to control and disperse the chapter's funds; and third, the fact that the petitioner used such funds in the subsidiary's checking account to pay for his personal and living expenses. In addition, the Tax Court noted that when circumstances exist in which a single individual controls the use of a church's funds for his own and his family's support, close scrutiny is required to determine if there has been a violation of the prescribed inurement provision of section 170(c)(2).

The last requirement a mail-order minister must meet in order to claim a charitable deduction is, as mentioned above, that he or she must prove that the organization receiving the gift is organized

139. Id.
140. Id. at 471-72 n. 3. (The McGahen court stated the bylaws set forth that the head of the BBC subsidiary held title to all real and personal property of such subsidiary). Id. at 482. With regard to this issue, the court noted that the petitioner who was ordained and established as "church personally" was head of the subsidiary. Id.
141. Id. at 473.
142. Id. at 474.
143. Id. at 470 and 473.
144. Id. at 482-483.
145. Id.
146. Id. at 482.
and operated exclusively for religious purposes as required by section 170(c)(2)(A). An organization is exempt from tax under section 501(c)(3) if it is organized and operated exclusively for, among other things, religious purposes. As previously mentioned, the requirements of sections 170(c)(2)(A) and 501(c)(3) parallel each other. Therefore, the law that has developed to administer the religious purpose exemption under section 501(c)(3) can be used to determine whether contributions to a church are deductible under section 170(a).

An institution is organized “exclusively” for a religious purpose if it is organized primarily for a religious purpose or such a purpose and other exempt purpose[s] under section 501(c)(3). A church will not qualify for tax-exempt status if a substantial part of its activities are not in furtherance of a religious purpose. Moreover, if there exists a single substantial nonexempt purpose, the exemption will be destroyed regardless of the number of truly exempt purposes.

The “organized exclusively” requirement has been used successfully to defeat mail-order ministry schemes. In Stephenson v. Commissioner, the church charter provided for the assets of the ministry to be returned to the donor upon dissolution of the organization if there was a disagreement among the board of trustees as how to dispose of the assets. In this case, as previously mentioned, the church’s founder, his wife and another individual, were the sole trustees of a subsidiary of the Life Science Church. Mr. Stephenson executed a vow of poverty and transferred all the family assets to the subsidiary. The minister and his wife were the only donors to the church. Most of the contributions received by

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150. Treas. Reg. § 1.501(c)(3)-1(a)(1) (as amended in 1976); supra note 9 at 919.
155. Id. at 1002.
156. Id. at 999.
157. Id. at 1000.
the church were spent on the couple's mortgage and homeowners insurance.\textsuperscript{158} The Tax Court denied the minister's charitable contribution deduction partly because the founder was one of the trustees.\textsuperscript{159} The founder could insure that the assets of the subsidiary would be returned to him on dissolution. The court ruled that the minister's control over the final disposition of the church's assets substantiated that it was not organized exclusively for an exempt purpose.\textsuperscript{160}

\emph{Hansen v. Commissioner}\textsuperscript{161} also evidences the denial of a minister's charitable contribution deduction because the church failed the exclusive organization requirement. In this case, the founder of the Church of Man, John Hansen, never performed religious ceremonies.\textsuperscript{162} The organization had little or no formal religious services.\textsuperscript{163} There were no large donations to the ministry other than those made by the founder and his wife.\textsuperscript{164} Moreover, the minister, as chairman of the church's governing body, caused the ministry to make a $300,000 award to his wife for her devotion in furthering the goals of the Church of Man.\textsuperscript{165}

The Tax Court, in \emph{Hansen}, determined that the lack of religious services and the payment to the founder's wife, were nonexempt activities which were more than incidental to the church.\textsuperscript{166} Accordingly, the court of appeals upheld the Tax Court's denial of the founder's charitable deduction because the Church of Man was not organized exclusively for religious purposes.\textsuperscript{167}

As mentioned above, under sections 170(c)(2)(A) and 501(c)(3), a mail-order minister must not only meet the exclusive organization test but must also meet the "operated exclusively" requirement.\textsuperscript{168} An organization is operated exclusively for a religious purpose if its activities primarily serve a religious purpose or such purpose and other exempt purpose[s] under section 501(c)(3).\textsuperscript{169}

\begin{itemize}
\item \textsuperscript{158} \textit{Id.} at 998.
\item \textsuperscript{159} \textit{Id.} at 1002.
\item \textsuperscript{160} \textit{Id.}
\item \textsuperscript{161} 820 F.2d 1464 (1987).
\item \textsuperscript{162} \textit{Id.} at 1466.
\item \textsuperscript{163} \textit{Id.}
\item \textsuperscript{164} \textit{Id.}
\item \textsuperscript{165} \textit{Id.}
\item \textsuperscript{166} \textit{Id.} at 1468.
\item \textsuperscript{167} \textit{Id.} See \emph{Pusch v. Commissioner}, 39 T.C.M. (CCH) 838 (1980).
\item \textsuperscript{168} See \textit{supra} notes 147-151 and accompanying text.
\item \textsuperscript{169} Treas. Reg. § 1.501(c)(3)-1(c)(1) (as amended in 1976).
\end{itemize}
The purpose of an activity, rather than the nature of the activity itself, is determinative of whether the institution satisfies the operational test. A church is not operated exclusively for religious purposes unless it is operated for the benefit of the public rather than for the benefit of a private interest.

Like the exclusive organization requirement, the exclusive operation test has been used successfully to defeat mail-order ministry schemes. For example, in Church in Boston v. Commissioner, a substantial portion of the church's funds were allocated to make grants to private individuals. Although the church argued that the grants were to give the poor financial assistance, the religious institution did not provide any evidence with regard to how the selection process was made. The Tax Court decided that these payments did not directly serve a religious purpose and were nonexempt activities. Accordingly, the court denied the church's exemption because the institution was held to not be operated "exclusively" for a religious purpose.

Basic Bible Church v. Commissioner is another example of the destruction of a church's exemption because it failed the exclusive operation requirement. In this case, the church's founder and his wife executed vows of poverty and transferred all of their personal assets to the organization on the condition that it qualified for a tax exemption. The founder and his wife were the primary donors to the church. Almost all of the donations received by the organization were spent on the founder and his wife for clothing, food, travel, and maintenance of their home. The founder, who made all the financial decisions of the church, allocated less than one percent of the organization's contributions to church related expenses. The Tax Court denied the religious institution's tax exemption and ruled that the church's nonexempt activities com-

173. Id. at 106.
174. Id. at 107.
175. Id.
176. 74 T.C. 846 (1980); aff'd, 739 F.2d 266 (7th Cir. 1984).
177. Id. at 850-851.
178. Id. at 857.
179. Id.
180. Id. at 850, 857-58.
prised more than a substantial part of the organization's total activities.\textsuperscript{181}

\textit{Ecclesiastical Order of Ism of Am v. Commissioner}\textsuperscript{182} is another example which demonstrates that a church's tax exemption can be denied if it fails the exclusive operation requirement. In this case, the petitioner was comprised of a home office and approximately twenty-six chartered orders.\textsuperscript{183} The petitioner conducted an active recruiting campaign for church members by emphasizing the tax benefits of becoming a minister in a church called the "Ism of Am."\textsuperscript{184} The materials given to potential members indicated the emphasis the church placed on tax benefits to its ministers.\textsuperscript{185} Individuals who were interested in becoming ministers in the petitioner's church were often taught about the tax benefits available.\textsuperscript{186} In addition, the prospective ministers received written instructions on how to avoid paying taxes through establishing tax-exempt chartered orders of the church.\textsuperscript{187}

The Tax Court found that the petitioner had a substantial nonexempt purpose which consisted of counselling individuals on the purported tax benefits available to ministers of the Ism of Am.\textsuperscript{188} The court denied the petitioner's tax exemption because the organization was not operated exclusively for religious purposes.\textsuperscript{189}

\subsection*{C. The Tax Reform Act of 1986}

The Tax Reform Act of 1986 ("TRA '86") will have an adverse impact on mail-order ministries. The "TRA '86" changed tax rates, charitable contribution deductions, and tax penalties which will decrease the number of mail-order ministries.

TRA '86 reduces the tax advantage of using the section 170 deduction method. In 1986, the maximum tax rate was fifty percent.\textsuperscript{190} In 1987, under TRA '86, it was roughly thirty-four percent.

\begin{itemize}
\item \textsuperscript{181} \textit{Id.} at 857-858.
\item \textsuperscript{182} 80 T.C. 833 (1983).
\item \textsuperscript{183} \textit{Id.} at 834.
\item \textsuperscript{184} \textit{Id.} at 834-5.
\item \textsuperscript{185} \textit{Id.} at 835.
\item \textsuperscript{186} \textit{Id.}
\item \textsuperscript{187} \textit{Id.} at 836.
\item \textsuperscript{188} 80 T.C. at 839.
\item \textsuperscript{189} \textit{Id.}
\item \textsuperscript{190} I.R.C. § 1(c)(3) (1954).
\end{itemize}
In 1988 and 1989, the tax rate is generally twenty-eight percent.\textsuperscript{191} Section 170 creates an itemized deduction.\textsuperscript{192} An itemized deduction is a deduction from adjusted gross income.\textsuperscript{193} A tax rate is applied to an amount of adjusted gross income resulting in an amount of tax due. A deduction from adjusted gross income decreases the amount of adjusted gross income which is subject to tax. Therefore, a deduction from adjusted gross income reduces tax less than the same deduction when a higher tax rate is used. Thus, the tax rate reduction under TRA '86 means that charitable deductions will provide less tax savings. Therefore, the incentive to claim section 170 deduction for mail-order ministers is reduced.

TRA '86 has also provided new tax penalties which should cause a decrease in the number of mail-order ministry schemes. The act increases the penalty for a substantial understatement of tax liability under section 6661 of the Code from ten percent to twenty-five percent of the amount of the underpayment of tax attributable to the understatement.\textsuperscript{194}

TRA '86 also makes the negligence penalty under section 6653(a) of the Code applicable to all taxes.\textsuperscript{195} The act also broadens the definition of negligence to include any failure to make a reasonable attempt to comply with the rules.\textsuperscript{196}

Furthermore, TRA '86 increases the fraud penalty under section 6653(b) of the Code from fifty percent to seventy-five percent.\textsuperscript{197} However, the fraud penalty will apply only to the portion

\textsuperscript{191} I.R.C. §§ 1(a)-(e), (h) (1986). TRA '86 sets forth two tax rates for individual taxpayers: a 15% rate and a 28% rate. See I.R.C. §§ 1(a)-(d). The Code phases out the benefit of the 15% rate for taxpayers whose income exceeds certain levels. I.R.C. § 1(g) (as amended by Section 1001(a)(3) of the Technical and Miscellaneous Revenue Act of 1988, "TAMRA"). These provisions in effect provide a third tax rate of 33% for these taxpayers on a part of their taxable income. This is set forth by means of an additional tax of 5% on taxable income that reaches certain levels. \textit{Id}.

\textsuperscript{192} I.R.C. § 170 (1988).


\textsuperscript{194} I.R.C. § 6661 (as repealed by Section 101(c) of the Technical and Miscellaneous Revenue Act of 1988, and amended by Pub. L. No. 99-509, section 8002(a) of the Omnibus Budget Reconciliation Act of 1986 ("OBRA '86").

\textsuperscript{195} I.R.C. § 6653(a) (as amended by Section 1015(b)(2)(A), and (B) of TAMRA).

\textsuperscript{196} I.R.C. § 6653(a)(3) (as amended by Section 1015(b)(2)(A), and (B) of TAMRA).

\textsuperscript{197} I.R.C. § 6653(b) (as amended by Section 1015(b)(2)(A), and (B) of TAMRA).
of the underpayment attributable to the fraud.\textsuperscript{198} If the IRS proves that any portion of the underpayment is attributable to fraud, the taxpayer must prove which portion of the underpayment is not attributable to fraud or the entire underpayment will be treated as a fraud penalty.\textsuperscript{199}

Finally, once the IRS notifies the taxpayer that it intends to levy upon the taxpayer's assets,\textsuperscript{200} the penalty for failure to pay taxes under section 6651(d) of the Code increases from one half percent to one percent per month. In addition, the court of appeals can assess damages against mail-order ministers and their attorneys for filing a frivolous appeal.\textsuperscript{201} These penalty changes will have a strong deterrent effect on a mail-order minister. One or more of these penalties may apply to a mail-order minister who has his or her section 170 charitable contribution deduction denied. The increase and broadening of penalties by Congress will provide the courts and the IRS with greater power to punish these tax protesters. The prospect of maintaining a mail-order ministry will become less cost-effective. Therefore, mail-order ministers will be less likely to accept the risk of being subjected to more of these penalties. This will cause the number of mail-order ministry schemes to decline.

V. SUMMARY AND CONCLUSION

The above discussion has demonstrated that the free exercise and establishment clauses of the Constitution provide restrictions on the courts and the government in their effort to prevent the proliferation of mail-order ministries. However, a minister cannot always use these constraints in order to have his or her charitable contribution deduction upheld. A mail-order minister must prove the following requirements in order to claim a section 170 deduction:

1. the charitable deduction was made for the same tax year in which the property is transferred;

\textsuperscript{198} I.R.C. § 6653(b)(1)(A) (as amended by Section 1015(b)(2)(A), and (B) of TAMRA).

\textsuperscript{199} I.R.C. § 6653(b)(2) (as amended by Section 1015(b)(2)(A), and (B) of TAMRA).

\textsuperscript{200} I.R.C. § 6651(d) (1988).

\textsuperscript{201} I.R.C. § 7482(c)(4); 28 U.S.C. § 1927; Fed. R. App. P. 38; see e.g. Kalgard v. C.I.R., 746 F.2d 1322, 1324 (9th Cir. 1985); Smith v. C.I.R., 800 F.2d 930 (9th Cir. 1986).
2. there has been a relinquishment of dominion and control over the property that was donated;
3. the property was transferred because of a charitable motive;
4. no part of the net earnings of the religious or charitable organization has inured to the benefit of any private shareholder/individual; and
5. the donee religious organization was organized and operated exclusively for religious purposes.

The inurement requirement is the best weapon in the arsenal for preventing the proliferation of mail-order ministries. This is because the proscription does not require a determination with respect to the sincerity of one's religious belief. In addition, every mail-order ministry situation involves the establishment of a church for the private benefit of its members and their families. Therefore, the inurement challenge may be used whenever a mail-order ministry exists. Finally, the law that has developed to thwart the claims of mail-order ministers is strengthened because of the impact of TRA '86.