CAN OTHER RELIGIONS BOLDLY GO WHERE ONLY SCIENTOLOGY HAS GONE BEFORE?

A relatively new church pioneers a tax break for religious education.

Kent Royalty, JD, LLM, CFP
Professor
St. Mary's University

Dianna Ross, PhD, CPA
Associate Professor
St. Mary's University

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Abstract

Members of the 50-year old Church of Scientology are currently enjoying a tax deduction for payments for religious training that other religions can perhaps only dream about. Scientologists are currently allowed a tax deduction for amounts spent for required religious training, whereas taxpayers of other religions have been denied attempts to deduct amounts spent on religious education. Startling to many, Scientologists were granted this deduction in a private IRS ruling despite the Supreme Court holding that payments for Scientology auditing and training were not deductible as charitable contributions.

This article discusses

- the conflict between the IRS and Scientology which resulted in the ability of Scientologists to deduct payments for "auditing and training" as charitable contribution,
- the frustrated attempts by members of other religions to gain comparable treatment,
- the Tax Court and the Supreme Court rulings on related issues, and
- the needed change to the relevant standard to accomplish more equitable treatment among taxpayers.

KEYWORDS:

Scientology, charitable contribution, religious tuition, tax deduction

INTRODUCTION

Taxpayers who are members of Scientology are able to deduct as charitable contributions amounts they were charged for required auditing and training. This deduction is startling to many, as the Supreme Court ruled that payments for Scientology auditing and training were not deductible as charitable contributions. However, the IRS, in a subsequent private ruling, granted the deductibility of these payments to Scientology taxpayers.

Accountant Michael Sklar attempted to gain equal treatment by claiming a deduction for a portion of his children's education in a Jewish school. Mr. Sklar's deduction was denied on the basis of his not meeting the criteria for charitable contributions.

Criteria for Charitable Contributions

More than a third of the $203.5 billion 2000[1] charitable contributions in the United States ($240.92 billion in 2002[2]) went to religious charities. A charitable contribution may qualify as an itemized deduction:

> … based on the theory that the Government is compensated for the loss of revenue by its relief from financial burden, which would otherwise have to be met by appropriations from public funds, and by the benefits resulting from the promotion of the general welfare.[3]

To ensure that deductions are granted only for those payments that truly represent charitable contributions, several requirements must be met. Among other criteria, a deductible payment must

- be made to a qualified recipient and
- be a contribution, not a payment for goods and services.

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[1] 2001. Sweet Charity. *U. S. News and World Report* (June 4): 10.
[2] American Association of Fundraising Counsel Trust for Philanthropy. 2003. Charity Holds its Own in Tough Times (Trust Press Release). Available at http://www.aafrc.org.

What does it take to be a qualified recipient?

Requiring a charity to qualify under I.R.C. § 170 as a legitimate recipient provides some protection to the federal treasury. Charitable contributions are generally allowed as itemized deductions on the taxpayer's income tax return as long as the contribution is made to a qualifying charity.[4] The Internal Revenue Code (I.R.C.) allows organizations to qualify to receive tax deductible contributions if organized for religious, charitable, scientific, literary, or educational purposes, to prevent cruelty to animals or children, to foster amateur sports competition and for a few other purposes.[5] Even these types of charitable organizations are further required to comply with restrictions on lobbying[6] and on whom may benefit from the contributions.[7]

Additional protection is provided by the denial of all or part of deductions when benefits enure to the contributor. A third protection against the abuse of the charitable contribution deduction has recently been provided by the substantiation requirements of I.R.C. §170 (f)(8) and §6115, which require contemporaneous written documentation for many charitable contributions.

Quid pro quo—when a contribution to a qualified charity is not a charitable contribution

Quid pro quo means "this for that", referring to getting something for giving something. Complications abound in transactions in which the taxpayer's payment may entitle the taxpayer to receive a benefit. For instance, otherwise qualified charities may also engage in commercial activities, such as occasional sales of real estate when the property is no longer needed for their

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[3] H.R. Rep. No. 1860, 75th Cong., 3d Sess. (1938), reprinted in 1939-1 (Pt.2) CB 728, 742.
[4] I.R.C. §170 (c).
[5] Id., also deductible may be gifts to U.S. states, territories and their subdivisions, as well as certain veterans organizations, fraternal organizations and cemetery companies.
[6] I.R.C. §170 (f)(9).

charitable endeavors. The purchaser of such real estate for fair market value is clearly not entitled to a charitable contribution deduction for this payment since they have already been fully compensated by the terms of their agreement.

Not all cases are as clear as the payment to a charity for real estate. For example, concern arises when the taxpayer's payment to the charitable organization has a mixed character or qualifies the taxpayer to receive a benefit that is less than tangible. For such cases, a clear decision rule is needed to differentiate the payments for contributions from those for the purchase of goods and services. Such a decision rule would minimize abusive deductions and loophole litigation.

The treatment by the IRS and the courts of the phrase "gifts and contributions" in §170 has been far from uniform. At times the *Duberstein*[8] "detached and disinterested generosity" test has been borrowed from §102(a) (gift vs. income considerations) and used to make the differentiation. In *Winters*, donations to a religious school (which the children of the taxpayer attended without charge but with an expected donation) were denied based on the lack of "detached and disinterested generosity". [9]

On other occasions, the courts have instead applied the "substantial/incidental benefits test."[10] Courts following this approach allow a deduction when the contributor to a charity receives only incidental benefits in return for a contribution.

Discounts to schools on Singer sewing machines were held not to be deductible contributions since the main purpose of the deduction was to create brand loyalty for Singer's machines in the students being taught to sew. Price reductions provided to other charities were allowed as

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[7] See, e.g., *Miedander v. CIR*, 81 TC 272 (1983).
[8] *CIR v. Duberstein*, 363 US 278, 285 (1960).
[9] *Winters v. CIR*, 468 F2d 778, 771 (2nd Cir. 1972).
[10] *Singer Co. v. United States*, 449 F2d 413, 423 (Ct. Cl. 1971).

charitable deductions since the main purpose was merely the maintenance of a favorable public image, an incidental benefit.[11] In *Singer Co. v. United States*[12], the Court of Claims differentiated "substantial" from "incidental" benefits, classifying as "incidental" those benefits received by the general public when a contribution is made to a charity. If the "donor" receives or expects to receive more than would be received by a member of the general public, then a quid pro quo transaction has occurred. In this situation the benefits are deemed substantial and the charitable contribution deduction will be denied. Typically, it is also presumed that the donor's feelings of internal satisfaction are not substantial benefits that would preclude a deduction; otherwise the deduction would prove elusive indeed.[13]

Another approach to the phrase "gift or contribution" is found in *Oppenwall* in which the Court simply found the charitable deduction to equal the amount by which the donation exceeded the benefit received.[14] This view was adopted and expanded by the Supreme Court in *United States v. American Bar Endowment (ABE)*[15] in which the Court established the general rule that an individual donor is entitled to a charitable contribution when giving an amount greater than the benefit being received in return. However, the Court made clear that this principal only applies when the payer *intends* to give more than received.[16] Otherwise anyone entering into a poor bargain with a qualified charity could claim a charitable deduction.

SCIENTOLOGY – A SAGA OF CONFLICT WITH THE IRS

One of the longer running and more intense battles in the arena of charitable contributions has involved the Church of Scientology, a worldwide religion that was founded in

[11] Id. at 424.
[12] Id.
[13] Id. at 423.
[14] *Oppewal v. Commissioner*, 468 F2d 1000, 1002 (1st Cir. 1972).
[15] *United States v. American Bar Endowment*, 477 U.S. 105 (1986).

the 1950's by L. Ron Hubbard.[17] Litigation between the IRS and members of the Church of Scientology concerned two issues addressed in I.R.C. §170 and §501.

Pertinent to §501, the IRS not only asserted that certain payments to the Church were not charitable contributions but also that the Church was not a qualifying charitable institution since it had a commercial purpose and permitted personal financial gain to Mr. Hubbard.[18] The IRS was successful in attempts to deny qualifying charity status to the Church of Scientology.[19] However, despite victories in the courts, the IRS retreated in a 1993 settlement that recognized tax-exempt status for the Church.[20]

Much more complex was the litigation over §170 charitable contribution deductions for members' payments to the Church for auditing and training. Basically, auditing and training are counseling and instructional programs designed to assist the Scientologist in attaining spiritual awareness, learning of their faith, and becoming qualified to conduct auditing sessions for other members.[21]

The Church of Scientology receives its primary financial support by charging members for these auditing and training sessions.[22] For a Scientologist to receive auditing and training, fixed payments of hundreds and sometimes thousands of dollars are required. The services purchased have fixed prices, cash discounts are available, and there are even refunds for unused portions.[23]

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[16] Id. at 118.
[17] *World Book Millenium 2000*. The World Book, Inc. Vol.17.
[18] *Church of Scientology v. Commissioner*, 823 F.2d 1310, 1315 (9th Cir. 1987).
[19] Id. at 1319.
[20] Streckfus, P. 1994. What We Know About The Scientology Closing Agreement, *Tax Notes* 131 (Jan 10).
[21] *Hernandez v. Commissioner*, 490 U.S. 680, 685 (1989).
[22] Id. Auditing consists of one on one sessions with a church trained auditor to identify areas of spiritual weakness and "training" is the instruction that teaches the member to be an auditor.
[23] Id. at 685. In 1972 Scientologists were charged $625 for a 12 ½ hour auditing intensive and up to $4,250 for a 100 hour auditing intensive.

Numerous Scientologists sought to deduct fixed payments for auditing and training as charitable contributions under §170. The nature of the payments, however, raised serious questions for the IRS and the courts concerning whether such apparent quid pro qui exchanges were legitimate charitable contributions.

After the IRS denied their deductions, many of the taxpayers sought relief in the Tax Court. The Tax Court affirmed disallowance of the deductions, finding the term charitable contribution to be the same as a gift and thus to be a transfer without consideration in return.[24] The taxpayer's payment for religious services was thus ineligible for a charitable contribution deduction. When numerous Scientologists who had lost in Tax Court appealed, a major split in the Federal Circuit Courts resulted. The second, sixth and eighth circuits upheld the deductibility of the fixed payments, while the first, fourth, ninth and tenth circuits denied the deduction. The United States Supreme Court finally addressed the consolidated cases in *Hernandez*.[25]

The Hernandez Decision

In the 1989 *Hernandez* decision, the U. S. Supreme Court denied the deductibility of amounts for auditing and training paid to the Church of Scientology.[26] The Supreme Court cited the legislative history of I.R.C. §170 to show that gifts and contributions were intended to be unrequited payments made with no expectation of quid pro quo from the charity. The legislative history also indicated that the expectation of receiving a quid pro quo in return for the payment was determined by reviewing the structural analysis of the transaction .[27] The Scientologists'

[24] Id. at 687.
[25] Id.
[26] Id. at 703. .
[27] Id. at 690, citing S. Rep. No. 1622, 83d Cong., 2d Sess., 196 (1954); H.R. Repl No. 1337, 83d Cong., 2d Sess., A44 (1954).

receipt of auditing and training in exchange for their payments clearly disqualified the transaction as a contribution or gift.[28]

The Court was not swayed by the argument that payments in exchange for purely religious benefits should be deductible as an exception to the general denial in quid pro quo cases. Noting that the language of the statute only allowed deductions for a payment that was a "contribution or gift" with no enumerated exceptions, the Court rejected the "religious benefit" exception based on the clear intent expressed in the statute.[29]

The Court also reasoned that allowing a deduction for payments that procured religious benefit would open the door for deductions in cases where the "donor" had received a myriad of benefits beyond what Congress had intended. If the quid pro quo test were removed, it is likely that more taxpayers would claim deductions of payments for tuition, counseling, and medical care provided by religious associations.[30] The Court was also concerned about church and state entanglement, as a decision for the Scientologist litigants would necessitate that the IRS and the courts screen deducted payments to see if they procured religious or secular benefits.[31]

The petitioners in *Hernandez* also raised constitutional claims of violation of the First Amendment's Establishment Clause and the free exercise of religion, as well as a claim of administrative inconsistency in enforcement of the tax laws. However, the Court found no such constitutional problems with the "structure of the transaction" test and rejected the inconsistency claim on the grounds that petitioners had failed to provide adequate support.[32]

In her dissenting opinion, in which Justice Scalia also joined, Justice O'Connor argued that it was unconstitutional to deny "…payments for the religious service of auditing to be

[28] Id. at 688.
[29] Id at 689-693.
[30] Id. at 693.
[31] Id. at 684.
[32] Id. at 694-700.

deducted as charitable contributions in the same way it has allowed fixed payments to other religions to be deducted."[33] She noted that the IRS had consistently allowed charitable contribution deductions for pew rents, payments for special masses, tithes, and other such fixed payments for religious services. Thus, the dissenters reasoned that either all religious quid pro quos should be deductible or none of them should be deductible.[34]

The clear decision by the U. S. Supreme Court majority in *Hernandez* would suggest that the matter was well settled and that other religions might well also lose deductions for their quid pro quo transactions for religious services. However, there remained the administrative inconsistency claim and the implementation of the Court's decision to finalize matters.

Surprisingly, the saga was about to take an unexpected turn. Not only did the IRS not attempt to extend the *Hernandez* decision to other religions; it confused matters by in effect overturning the Supreme Court *Hernandez* decision in 1993 with Revenue Ruling 93-73.[35] This Revenue Ruling allowed the deduction of the very payments the Supreme Court had refused. The *Powell* case[36] provides some understanding of the unusual behavior by the IRS.

The Powell Decision

The administrative inconsistency claim that was denied for lack of a sufficient record in *Hernandez* was picked up again and presented in the 1990 case of *Powell v. United States*. Powell, a Scientologist who had his charitable deductions to the Church of Scientology denied, paid his deficiencies and then pushed his case all the way to the 11th Circuit seeking to show the

[33] Id. at 707.
[34] Id.

[35] See Eaton, A. 1996. *Legal Issues In Cyberspace: Hazards On The Information Superhighway; Comment: Can The IRS Overrule The Supreme Court*, 45 Emory Law Journal 987 for an excellent discussion of the legality of the IRS attempts to ignore or overturn the Supreme Court's *Hernandez* decision.
[36] *Powell v. United States*, 945 F2d 374 (11th Cir, 1991)

discriminatory application of the law among various religions. Powell argued that the IRS had permitted deductions for other taxpayers that had made fixed payments in order to participate in religious services and thus it was wrong not to allow him similar deductions. The 11th Circuit held that Powell had presented a case for which relief could be granted and remanded the case to the District Court which had earlier dismissed the suit.[37] Before the District Court had opportunity to review the *Powell* case, however, the IRS began a process of capitulation which ended this particular litigation thread. It may be inferred that the IRS was concerned about losing the *Powell* case and being forced into the politically unpopular position of denying deductions for fixed payments made by members of religions with longer histories.

An Unexpected Turn of Events in Revenue Ruling 93-73

On October 1, 1993 the IRS issued numerous exemption letters to Scientologist organizations providing them with tax-exempt status.[38] Shortly thereafter, in November 1993 the IRS stunningly released Revenue Ruling 93-73.[39] This allowed the charitable contribution deductions which had been denied in *Hernandez*. It did so by making obsolete Revenue Ruling 78 – 189, which had declared that payments for Scientology courses in auditing and training were akin to tuition payments in private religious schools and thus were nondeductible. Revenue Ruling 93-73 naturally rendered moot the administrative inconsistency claims of *Powell* and ended the litigation but not the controversy. As an article in Forbes asked, "What makes tuition paid for classes in one religion more deductible than tuition for classes in another?"[40]

[37] Id. at 377.
[38] Streckfus. P. 1993. *Church of Scientology Recognized as Tax Exempt*, 61 Tax Notes 279.
[39] Rev. Rul. 93-73, 1993-2 C.B. 75 (declaring Rev. Rul. 78-189, 1978-1 C.B. 68, obsolete).
[40] McMenamin, B. 2000. Mysterious Ways, *Forbes* (Sept.4).

Some questioned the lack of candor exhibited by the IRS in this settlement.[41] The IRS was not forthcoming as to its reasons for the settlement and for turning its back on its victory in *Hernandez*. Numerous authorities wrote to question whether the IRS could legally ignore, and in effect, overturn a Supreme Court decision.[42]

In considering the probable cause for the unexpected action by the IRS, it seems likely that one motive was to end the costly and draining forty-year struggle with the Scientologists so that administrative resources and finances could be directed elsewhere. For whatever reason or reasons, the IRS chose to use a Revenue Ruling to resolve the issue. Since taxpayers are not allowed to challenge another taxpayer's tax return, this makes it difficult, if not impossible, for anyone other than an affected Scientologist to challenge the IRS action.[43] As Scientologists are pleased with the result, such a challenge is unlikely.

It does appear, however, that Revenue Ruling 93 –73 is subject to challenge on the same basis that Scientologists argued administrative inconsistency in *Powell*. Furthermore, it appears that Revenue Ruling 93 – 73 opens the way to challenges by all types of taxpayers formerly denied certain types of charitable contributions due to Revenue Ruling 78-189, just as the Supreme Court majority feared and predicted in *Hernandez.*[44]

Supreme Court *Hernandez* Fears

One of the reasons the Supreme Court specifically articulated for the denial of the charitable contribution deduction in *Hernandez* was the fear of widening the deduction beyond

[41] Kurtz, J. 1994. *IRS Should Fully Explain its Settlement with Church of Scientology*, 63 Tax Notes 1783 (June 27).
[42] See Streckfus, P. 2000. *Latest Ruling Provides More Good News For The Scientologists*, 61 Tax Notes 643.
[43] *Supra* n.36 (As explained by Alison Eaton, a taxpayer may not challenge anther taxpayer's return. Revenue Ruling 93-73 applies only to Scientologists. Scientologists, therefore, appear to be the only taxpayers capable of challenging it. It is possible that the IRS was relying on the finality of Revenue Ruling 93 –73 to avoid any challenges to the ruling based on the *Hernandez* decision.
[44] *Hernandez*, 490 U.S. 680.

what Congress had intended.[45] The Court explained that "[n]umerous forms of payments to eligible donees plausibly could be categorized as providing a religious benefit or as securing access to a religious service."[46] The Court then specifically mentioned tuition payments to parochial schools, church-sponsored counseling sessions and medical care at church-affiliated hospitals, all of which are currently not deductible as charitable contributions and which could arguably be included under a looser standard of religious benefit or providing access to a religious service.[47] This raises no small problem since taxpayers spend $11 billion per year on religious education alone.[48]

The Court also worried about broadening the IRS purview to include distinguishing between religious benefits and secular benefits.[49] Such distinctions could be problematic since many churches seek to minister to the whole person by providing child care, education, nutrition, health, entertainment and recreation, all under the umbrella of religion. If such a broad standard as the religious benefit test were articulated, it would threaten the public coffers and could result in protracted litigation and court intervention.

SKLAR ASKS FOR COMPARABLE TREATMENT

The Supreme Court's concern about the expansion of deductions for religious education seems to have been realized in a 2000 Tax Court case, *Sklar v. Commissioner*.[50] In this case, taxpayers sought deductions for tuition payments to the Jewish schools that their children attended. The deduction they sought was total tuition paid, reduced by the 45 percent of the education that the school officials deemed to be for secular education. Thus, the Sklars were

[45] Id. at 693.
[46] Id.
[47] Id.
[48] McMenamin, *supra* n. 41.
[49] *Hernandez*, 490 U.S. 680, 694.

only seeking a deduction for the payments that they had made for the religious training of their children.[51] They claimed that the payments for religious training were akin to payments made by Scientologists for auditing, for which the IRS allows a charitable contribution deduction. The Sklars went on to argue that if their deduction were denied, the IRS would be violating the First Amendment Establishment Clause by discriminatory enforcement.[52] In fact, this is the same argument the Scientologists used in *Powell* during their struggle for equal treatment with fixed payments made to other religions.[53]

The Tax Court relied on the decisions in *Dejong*[54] and *Winters*[55] to deny the deduction. The Court held that the tuition payments were made with the anticipation of economic benefit above and beyond the satisfaction which flows from the performance of a generous act. They are therefore not charitable contributions. [56] Not even the $75 paid for an after-school class in the Talmud was allowed.[57]

The Tax Court dismissed Sklar's contention that the First Amendment Establishment Clause was violated by alleged preferential tax treatment to one religion. The Court reasoned that the tax treatments were differential, not preferential, being due to differences in the nature of consideration received for the payments, not the differences in the religions in question. Although no part of the Scientologist auditing had secular value, there is a secular and partial economic value in Sklar's religious school tuition.

According to the Court, there is a secular and partial economic value in religious school tuition. The Court took this stance even though the Supreme Court clearly stated in *Hernandez*

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[50] *Sklar v. Commissioner*, T.C. Memo 2000-118.
[51] Id.
[52] Id.
[53] *Powell v. United States*, 945 F2d 374, 376.
[54] *DeJong v. Commisssioner*, 309 F2d 373,376 (9th Cir. 1962) affg. 36 T.C. 896 (1961).
[55] *Winters v. Commissioner*, 468 F2d 778,781 (2nd Cir. 1972) affg. T.C.Memo. 1971-290.
[56] *Sklar*, T.C. M. 2000-118.

that secular/religious value was not the test for deductibility of charitable contributions. The Supreme Court was adamant that deductibility be limited to transactions that maintained the appropriate structure and were not transacted as quid pro quo arrangements. This was deemed necessary to ensure that the courts would not be drawn into making entangling judgements about value.[58]

Furthermore, by implying that the Scientologist's auditing payments were not made in order to procure anticipated benefits, the Tax Court either ignores the Supreme Court's decision in *Hernandez* or makes the distinction that the Supreme Court saw good reason not to make. In fact, the Supreme Court's opinion in *Hernandez* specifically anticipated that allowing a deduction for auditing payments would open the door for deductions of religious tuition payments and other such similarly situated payments.[59] The Supreme Court has made it clear that there certainly may be charitable contributions which are partially purchases and partially contributions, so the Tax Court's reliance on "no secular value" seems strained at the very least.[60] Again the question resonates from Forbes: why allow deductions for religious education of one religion and not another?[61]

Appeal To The United States Court Of Appeals For The Ninth Circuit

The Sklars continued to press for the deductibility of the religious 55 percent of their tuition payments for their children, arguing that the

> "costs are deductible under section 170 of the Internal Revenue Code, as payments for which they have received 'solely intangible religious benefits.' They also argue that they should receive this deduction because the IRS permits similar deductions to the Church

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[57] McMenamin, *supra* n. 41.
[58] *Hernandez*, 490 U.S. at 694.
[59] Id. at 693.
[60] *American Bar Endowment*, 477 U.S. at 118.
[61] McMenamin, *supra* n. 41.

> of Scientology, and it is a violation of administrative consistency and of the Establishment Clause to deny them… the same deduction." [62]

In denying the Sklar's appeal, the Ninth Circuit relied on *Hernandez* to refute the contention that a quid pro quo charitable contribution is deductible when only religious benefit is received in return. Ultimately, the Court affirmed the Tax Court's denial of a charitable contribution deduction based on the *American Bar Endowment* test for deductibility of dual payments (payments intended to accomplish two objectives) in which the taxpayer must establish that the payment exceeds the market value of the benefits received in return. Fatal to the Sklar's case was their failure to show that their dual payment (for secular education and religious education) exceeded the market value of other secular private school education.

Additionally, the Court *in dicta* explained that if it had been called on to decide if the IRS had created an unconstitutional denominational preference, the Court would have applied the Supreme Court's *Larson v. Valente* test.[63] This test is applied by determining whether the IRS discriminates among religions and whether such discrimination is justified by a compelling government interest. The Court opined that if it were required to reach a decision, it would find that the IRS' preference for the Church of Scientology is not justified by a compelling governmental interest and therefore constitutes an unconstitutional denominational preference. However, despite apparent sympathy for the Sklars' position, the Court reasoned that it would not be inclined to expand the Scientologist's deduction to the Sklars and other religious groups but would likely rule that the policy allowing deductions for fixed payments made by

[62] *Sklar v. Commissioner*, 282 F3rd 610 (Ninth Circuit, Jan. 29, 2002).
[63] *Larson v. Valente*, 456 US 228, 246-47 (1982).

Scientologists "be invalidated on the ground that it violates either the Internal Revenue Code or the Establishment Clause"[64].

As Justice Silverman noted in a concurring opinion,

> "[i]f the IRS does, in fact, give preferential treatment to members of the Church of Scientology—allowing them a special right to claim deductions that are contrary to law and rightly disallowed to everyone else – then the proper course of action is a lawsuit to stop that policy. (footnote omitted) The remedy is not to require the IRS to let others claim the improper deduction, too.[65]

The Sklars Try Again

The Sklars have returned to Tax Court and are again suing the Internal Revenue Service. The Sklars claim that the denial of a charitable contribution deduction for the religious portion of the children's tuition while permitting members of the Church of Scientology to write off religious counseling and instruction violates their First Amendment rights. In interviews, the Sklars have explained that they are not seeking to end the deduction for Scientologists but to make them available for other religions. As Michael Sklar explained, "[i]t sets a dangerous precedent because you have a particular religion being favored by the IRS."[66] To borrow the phraseology of Justice Silverman in his concurring opinion, it is time to finally address the concern that the members of the Church of Scientology have become the IRS' chosen people.[67] The Sklar's new trial began Fall 2004.

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[64] *Sklar*, 282 F3rd 610.
[65] Id. at 623.
[66] 2004. *Lawsuit May Set Deadly Precedent; Religious Day School Tuition Write-off At Issue*, The Daily News of Los Angeles (April 1).
[67] *Sklar*, 282 F3rd at 622.

PROPOSED CODE CHANGES

The potential for the expansion of the charitable contribution deduction by several billion dollars makes it imperative that the uncertainty introduced to the area be eliminated by clear, unambiguous congressional action. In developing a fair system, Congress needs to balance the legitimate differences in charitable fund raising by various religions while at the same time insuring that taxpayers are not abusing the system by writing off personal expenses as charitable contributions, or at least not beyond tolerable de minimus amounts.

A casual reading of the legislative requirements created by Congress in 1993 for substantiation and disclosure of charitable contributions might lead to the conclusion that Congress had resolved the issue of valuing religious benefit in the charitable contribution context. Section 170 (f)(8) requires that any charitable contribution in excess of $250 be substantiated with a contemporaneous written acknowledgement of the contribution from the donee charity. The acknowledgement must describe and estimate the value of any goods and services received in return for the contribution. Only a statement recognizing the provision of intangible religious benefit is necessary if that is the only good or service acquired from the charity; no estimate of value is required. Intangible religious benefit is defined in §170 (f)(8) as "provided by an organization organized exclusively for religious purposes" and generally "not sold in a commercial transaction outside the donative context."

Section 6115 requires that a charitable organization receiving a quid pro quo contribution in excess of $75 must inform the donor in writing of the limits on quid pro quo donations and specify the value of the goods and services received. For purposes of §6115 a contribution acquiring intangible religious benefits does not constitute a quid pro quo transaction.

While the language of this legislation seems to indicate that Congress felt that non-economic religious benefit provided in exchange for a payment to a charity should not preclude deductibility, the 1993 legislation dealt solely with substantiation and disclosure matters and never addressed deductibility. Nor is there any indication in the legislative history of the 1993 legislation that it was intended to rectify the problems created by *Hernandez*.[68] As the Ninth Circuit stated in *Sklar*, "(t)he amendments to the Code appear not to have changed the substantive definition of a deductible charitable contribution, but only to have enacted additional documentation requirements for claimed deductions."[69]

Is the Tax Court and the IRS departure from Supreme Court guidance based on a type of statutory interpretation that looks at what the legislature would do if it were enacting the charitable contribution deduction today? The contribution substantiation requirements exclude intangible religious benefits. Have the Tax Court and the IRS reasoned that Congress would be equally unconcerned with intangible religious benefits in the "gifts and contributions" context?

One approach was suggested in "Internal Revenue Code Section 170: Does the Receipt by a Donor of an Intangible Benefit Reduce the Amount of the Charitable Contribution Deduction? Only the Lord Knows for Sure".[70] The article calls for the I.R.C. §170(f)(8) and §6115 substantiation requirement definitions to be extended to the substantive area of "gifts or contributions" in §170. This approach would allow the receipt of intangible religious benefits to be ignored in quid pro quo situations. Specifically, the author suggests adding the following language to §170:

> (1) In a quid pro quo contribution, the amount of the charitable contribution under this section is limited to the excess of the amount of any money and the value of any property other than money contributed by the donor over the value of the goods and services

[68] H.R. Rep. No. 111, 103d Cong., 1st Sess. 784 (1993).
[69] *Sklar*, 282 F3rd at 613.
[70] 64 Tenn. L. Rev. 91 (Fall 1996).

> provided by the donee organization. (2) For purposes of this section, the term "quid pro quo contribution" means a payment made partly as a contribution and partly in consideration for goods or services provided to the payer by the donee organization. A quid pro quo contribution does not include any payment made to an organization, organized exclusively for religious purposes, in return for which the taxpayer receives solely an intangible religious benefit that generally is not sold in a commercial transaction outside the donative context.[71]

This proposed legislative language would address the current confusion that prevails in the area of quid pro quo transactions. It does not discriminate against religious associations that may by their own religious tenets be required to raise funds in a quid pro quo style transaction. Left intact would be the §170 test of whether an organization is a legitimate charity. The suggested legislation also makes it clear that partial deductions are allowed for mixed purchase and donation situations, as the courts have consistently confirmed.

The suggested language further provides the additional shelter to religious associations alone. This limitation is essential to prevent the expansion of attempted deductions and litigation to numerous other types of charities. Charities other than religions should not need the proposed additional legislative latitude since they should be able to structure their fund raising in such a way as to avoid quid pro quo transactions and related problems in deductibility.

Finally, and perhaps most importantly, the proposed statutory change is very narrowly worded to prevent most attempts to find refuge in the exception that it provides to the general rule. The "intangible religious benefit" limit forestalls any attempts to include tangible property in this exception. As a second limitation, the religious benefit is limited to a "benefit not generally sold in a commercial transaction outside of the donative context." This limiting phrase also addresses many of the fears expressed by the Supreme Court in *Hernandez,* that if the Court did not deny the deduction based on the transaction's quid pro quo style, then all forms of purchased services would be allowed as deductions or would at least be litigated in such an

[71] Id. at 153.

attempt.[72] Numerous providers other than religions and charities sell services such as medical treatment, day care, and country club type facilities openly in the free market, so these services should easily be precluded.

While the suggested legislation would effectively solve the discriminatory treatment among religions for the receipt of intangible religious benefits, the question remains whether the line drawn would be as clear for the $11 billion spent annually for religious school and seminary education. The religious portions of these services are sold quid pro quo, but not usually by anyone other than the particular sect that is providing the religious portion of the education. The religious instruction is certainly intangible and is provided by a qualifying religion. It appears that purchases of these religious benefits would naturally correspond to the Scientologists' purchase of auditing and training and thus fit naturally into this exception with them. If some have been commercialized and others have not, this may be due primarily to the size and recency of some religions as compared to others. If this issue is left unclear, this still could prove very expensive to the public tax revenue and could provide opportunity for protracted litigation. This is especially true if some religions are allowed to deduct their religious education while others are not. Congress needs to bring additional clarity and equality to this area in particular, drawing a clear and unambiguous line.

If equitable treatment among religions were to be accomplished by reversing the effect of Revenue Ruling 93-73, the IRS would need to clarify in regulations the concept that purchasing religious education for oneself or one's dependants has been traditionally treated as a commercial and personal transaction and is thus not deductible as a charitable contribution. This would return equality to all religious education expenses, permitting deductions for contributions

[72] *Hernandez*, 490 U.S. at 693.

for religious services, which tend to benefit the public (Congress' original intent), while disallowing deductions for the more private benefit of instruction to the individual.

If Congress should desire to leave Revenue Ruling 93-73 intact and allow Scientologists to deduct their quid pro quo educational expenses based on the notion that their individual educational programs are not commercially available or that they are the equivalent of public worship in other religions, then fairness dictates that even longer-established religious groups be allowed an equivalent deduction for the religious portion of their quid pro quo religious educational expenses, as well. This should apply regardless of whether the education is fully religious or mixed with secular instruction, because the concept of a partial deduction for a mixed gift/purchase is well established and is specifically permitted by the suggested legislation. All benefiting taxpayers would, of course, bear the burden of demonstrating and substantiating the deductible amount. Of course this approach, though equally neutral to all religions, would significantly reduce federal tax receipts.

If Congress is unwilling to address this issue and bring equality and closure to this important area, the courts and the IRS need to follow the standard articulated by the Supreme Court and continue the narrow construction of "gift or contribution". By refusing to allow quid pro quo transactions to qualify as "gifts or contributions" the courts will avoid the write-off of personal expenses and excessive entanglement of the courts into religious practices. It seems unusual to have to argue for the federal courts to follow the Supreme Court's decision. It would seem necessary in this instance, however, given the IRS's apparent disregard for the Supreme Court's direction.