

ORIGINAL

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SUPREME COURT, U.S.
WASHINGTON, D.C. 20543

OFFICIAL TRANSCRIPT
PROCEEDINGS BEFORE

THE SUPREME COURT
OF THE
UNITED STATES

CAPTION:

ROBERT L. HERNANDEZ, Petitioner V. COMMISSIONER
OF INTERNAL REVENUE; and
KATHERINE JEAN GRAHAM, ET AL., Petitioners V.
COMMISSIONER OF INTERNAL REVENUE

CASE NO:

87-963 & 87-1616

PLACE:

WASHINGTON, D.C.

DATE:

November 28, 1988

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1 IN THE SUPREME COURT OF THE UNITED STATES

2 -----x
3 ROBERT L. HERNANDEZ, ;

4 Petitioner ;

5 v. ;

No. 87-963

6 COMMISSIONER OF INTERNAL ;

7 REVENUE; and ;

8 KATHERINE JEAN GRAHAM, ET AL., ;

9 Petitioners ;

10 v. ;

No. 87-1616

11 COMMISSIONER OF INTERNAL ;

12 REVENUE ;
13 -----x

14 Washington, D.C.

15 November 28, 1988

16 The above-entitled matter came on for oral
17 argument before the Supreme Court of the United States
18 at 1:50 o'clock p.m.

19 APPEARANCES:

20 MICHAEL J. GRAETZ, ESQ., New Haven, Connecticut; on
21 behalf of the Petitioners.

22 THOMAS W. MERRILL, ESQ., Deputy Solicitor General,
23 Department of Justice, Washington, D.C.; on
24 behalf of the Respondents.

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C O N T E N T S

ORAL ARGUMENT OF	PAGE
MICHAEL J. GRAETZ, ESQ.	
On behalf of the Petitioners	3
THOMAS W. MERRILL, ESQ.	
On behalf of the Respondents	25
REBUTTAL ARGUMENT OF	
MICHAEL J. GRAETZ, ESQ.	
On behalf of the Petitioners	50

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P R O C E E D I N G S

(1:50 p.m.)

CHIEF JUSTICE REHNQUIST: We'll hear argument next in No. 87-963, Robert Hernandez v. the Commissioner of Internal Revenue, and 87-1616, Graham v. Commissioner of Internal Revenue.

Mr. Graetz, you may proceed whenever you are ready.

MR. GRAETZ: Chief Justice Rehnquist, may it please the Court:

Although I appear here today on behalf of taxpayers in these cases, my position is quite unusual.

My purpose is to convince you to endorse the interpretation of Section 170 of the Internal Revenue Code first announced by the IRS in 1919 and, with the exception of this litigation, maintained consistently by the IRS since that time, at least through September 22nd of this year, when IRS Assistant Commissioner Brower restated what he described as the cumulative IRS position in these terms.

And I quote, "Religious observances generally are not regarded as yielding private benefits when attending the observances. The primary beneficiaries are viewed as being the general public and members of the faith.

1 "Thus, payments for saying masses, pew rents,
2 tithes, and other payments involving fixed donations for
3 similar religious services are fully deductible
4 contributions."

5 This case, Your Honor, involves fixed
6 donations for religious services. And under the
7 position of the IRS for the last 70 years, the payments
8 should be fully deductible contributions.

9 QUESTION: He did say "generally" in that
10 quote that you read, didn't he, in that first sentence?

11 MR. GRAETZ: He did say generally, Your
12 Honor. But in the case of making distinctions among
13 religions for disallowing deductions by the participants
14 and members of that faith to participate in religious
15 observances, I think that the IRS and this Court should
16 await guidance from Congress about what it means to
17 distinguish among religions on these grounds.

18 QUESTION: Well, Mr. Graetz, what flexibility
19 does the IRS have to change its view in its regulations
20 from time to time? And doesn't it do so in other
21 instances? And has this Court ever taken the view that
22 it can't change its mind?

23 MR. GRAETZ: Justice O'Connor, this Court has
24 in numerous opinions expressed that in the tax law there
25 is a need for clarity, particularity, predictability,

1 and special deference to the IRS.

2 There are only two cases in the last decade
3 that this Court has endorsed a change in administrative
4 position by the IRS.

5 The first is the Bob Jones University case,
6 and in that instance the majority of the Court found
7 considerable evidence in the legislature that the change
8 in IRS position was one that Congress intended the IRS
9 to make.

10 The other instance was a case involving
11 interest-free loans under the Gift Tax, and the
12 treatment of interest-free loans under the Gift Tax.
13 And there you had a dramatic change in economic
14 circumstances -- It's the Dickman case, Your Honor.

15 You had a dramatic change in economic
16 circumstances that made Gift Tax avoidance possible
17 through the use of interest-free loans where no such
18 avoidance had been possible in prior years until the
19 change in circumstances.

20 Those are the only two instances that I'm
21 aware of in the last decade that this Court has endorsed
22 such a position.

23 Here the IRS has not expressed a change in
24 position through regulation, it has not withdrawn
25 rulings to the contrary, it has not announced a general

1 principle for churches and synagogues, and their members
2 to follow.

3 It in fact doesn't seem to have changed its
4 administrative position, if, if Commissioner Brower is
5 stating the position correctly.

6 QUESTION: Well, Mr. Graetz, even if we accept
7 your approach to the deductibility for auditing, what
8 about training? And why isn't that like tuition and
9 non-deductible?

10 MR. GRAETZ: Well, Your Honor, I -- let me,
11 let me respond in two ways.

12 One is, I think that the case law and the
13 precedents clearly distinguish tuition at religious
14 schools, which involve a secular --

15 QUESTION: And tuition isn't deductible, is
16 it?

17 MR. GRAETZ: It's not deductible.

18 QUESTION: Why should it be, why should
19 payments be deductible for training?

20 MR. GRAETZ: Well, the Court below did not
21 distinguish auditing and training. The stipulations
22 indicate that training involves an educational component
23 that is not involved in auditing.

24 However, the testimony, the uncontradicted
25 testimony below, was that training is similar to the

1 study of sacred texts, in various other religions. And
2 the court, the tax court, which made the factual
3 findings, found that these were payments for religious
4 services without distinguishing the payments for
5 training and the payments for auditing, although I think
6 that there may be some --

7 QUESTION: But you concede there may be a
8 basis for making that distinction?

9 MR. GRAETZ: Well, I think, Your Honor, that
10 the only basis that I, that I can see in the record for
11 making that distinction is where the training is
12 undertaken for the purpose of, of becoming a minister,
13 that is of employment.

14 And the taxpayers in the cases below did not
15 undertake the training for that purpose. They only
16 undertook the training for religious purposes. And in
17 that case I think it's like Sunday School that's
18 normally included in the dues of a church --

19 QUESTION: Would the deductibility of tuition
20 at a theology school be dependent on whether you want to
21 be a minister when you get through?

22 MR. GRAETZ: No, Your Honor. I think that
23 here the test is one that needs to be limited to the
24 conduct of religious worship, and in limited cases
25 perhaps, religious instruction.

1 But I would not go beyond that, and it is
2 really the fact that the tax court below did not make
3 any factual findings that are different about the two
4 services, that it clearly regarded training in these
5 cases as a form of religious worship, and not a form of
6 religious education, or a form of secular education with
7 religious components.

8 The crucial issue, I think, below, was that
9 the payments here are fixed and mandatory. And I think
10 that is the basis of the appellate court's decisions
11 that affirmed the tax court decision.

12 And I think that that issue is one that has
13 been terribly confused in, in the courts and in which
14 some clarification is necessary.

15 QUESTION: Excuse me. Before you move on,
16 just something you said. Is it conceded that this was
17 religious worship as opposed to religious instruction?
18 Is that part of the stipulation?

19 MR. GRAETZ: The finding of fact and the
20 stipulations are that with respect to auditing, there is
21 no educational component.

22 With respect to training there is an
23 educational component. And the tax court found that the
24 taxpayers had made their payments to participate in
25 religious services, so that the tax court did not

1 distinguish the educational component of training.

2 And these taxpayers, the taxpayers who
3 undertook training in this case, all testified that they
4 did so as a study of sacred text and the expert witness
5 who testified testified the same things.

6 So it seems to me that the tax court's finding
7 of fact in this case is a reasonable finding of fact.

8 QUESTION: One can study a sacred text
9 without, without worshiping. I mean, one could go to,
10 you know, theology school and study sacred text, and
11 that's not necessarily an act of worship, as are many of
12 the other examples that you, that you raise in your
13 brief, such as high holy day services and so forth.

14 MR. GRAETZ: No, Your Honor, and all, all that
15 we are asking is that, that religious observances, the
16 conduct of religious worship, which is a phrase that
17 appears in the Internal Revenue Code regulations
18 numerous times, is not the sort of quo -- to use the
19 government's repetitive phrase of quid pro quo -- is not
20 the sort of quo that will disqualify charitable
21 contribution deductions.

22 And we do not take the position that education
23 is deductible. There are cases, there's a long line of
24 authority that says that payments to a parochial school,
25 or a religious school, are non-deductible, and I think

1 that would apply to a divinity school as well.

2 It is here that the, that the act of studying
3 the sacred text is in fact an act of worship, and it can
4 be an act of worship, and the tax court seems to have so
5 found, although its opinion here does not, is not a
6 model of clarity on this point, because it did not
7 distinguish the auditing from the training in, in these
8 cases.

9 It is -- It is also important to note,
10 however, that in all of the cases that the government
11 relies upon, that deductions have been disallowed in
12 whole or in part, and they almost always are in part,
13 for payments in order to participate in religious
14 education.

15 That -- those cases, and here I'm talking
16 about Oppewal and DeJong and Haak and the cases the
17 government cites, those cases involve voluntary
18 payments, not fixed payments, and not mandatory payments.

19 In fact, the Oppewal case, which the IRS
20 addresses in a revenue ruling that the government relies
21 upon, in a 1983 revenue ruling, is described in a, in a
22 situation in that ruling, as situation four, and in that
23 situation the, the person in charge of the school came
24 and sat down with each parent and discussed what would
25 be an appropriate contribution.

1 And that's very similar to the kind of
2 fundraising that occurs in many churches throughout this
3 country. And in that case the court said, the deduction
4 is allowed only to the extent that it exceeds the cost
5 of the education.

6 Now the reason for that in the Internal
7 Revenue Code is clear. There you had secular education
8 that had a religious component. The reason for that is
9 that there are regulations under Section 262 that limit
10 the ability of people to deduct their educational
11 expenses.

12 And the court was very concerned, and the
13 courts have been concerned in the religious education
14 context with not permitting people to obtain deductible
15 education when offered by a church and not be allowed to
16 deduct it when offered elsewhere.

17 And this Court itself, in the Bob Jones case,
18 distinguished religious education from religious
19 services. And we have no, we have no quarrel --

20 QUESTION: Well, the arrangement, the
21 arrangement here was for a fixed sum to be paid, wasn't
22 it?

23 MR. GRAETZ: The arrangement in this case was
24 for a fixed sum to be paid, yes.

25 QUESTION: How does that come about? Is it --

1 do they enter into, does the church enter into an
2 agreement? Or is it just a piecework basis that any
3 time you come for a training session you pay some
4 money? Or is there some agreement in advance?

5 MR. GRAETZ: There is a schedule, a schedule
6 based on the hours of worship, where the payment is set
7 by the church and the people who participate make that
8 payment. And it is a fixed payment.

9 QUESTION: So the --

10 QUESTION: Don't we have to distinguish
11 between auditing and training though, when you talk
12 about this?

13 MR. GRAETZ: Well again, Your Honor, I -- the
14 payments are set on an hourly basis, and the payments
15 are fixed. It is our position that the fact that the
16 payments are fixed and required really cannot be, cannot
17 be crucial to this case. It can't make a difference.

18 And I think the distinction is, between
19 auditing and training is the one that we've just
20 discussed, educational --

21 QUESTION: So for all practical purposes,
22 worshipping in this church is not permitted except upon
23 paying a certain sum every time you worship?

24 MR. GRAETZ: Well, Your Honor, there are a
25 number of free services that are given by this church.

1 The participation in this religious service is attended
2 by a fixed price.

3 QUESTION: And you say that that's -- if you
4 want to worship you have to pay, and therefore you
5 certainly should be able to deduct it. I gather that's
6 your argument.

7 MR. GRAETZ: My argument is that, that the
8 fixed and mandatory nature of the payment has never
9 before been held to be crucial in determining whether or
10 not a charitable deduction is or is not allowable, that
11 in a case of secular education it doesn't matter whether
12 the payment is voluntary or set by the, set in
13 accordance with discussions.

14 All that matters is the value of the benefit
15 on the other side. And, in each of the cases that has
16 been cited before this case today, the critical
17 question, and it was the question in the American Bar
18 Endowment case, is always, does the amount of the
19 payment exceed the value of what is received in return?
20 And if it does, then it is deductible.

21 And no court has ever held that the value of
22 religious worship is one that can be ascertained by the
23 IRS or by the courts.

24 QUESTION: So if a church says, well, we'll
25 let you become a member of our church if you promise

1 every year from now on to contribute \$10,000. That's
2 the only, that's the only way you can come and worship
3 in our church.

4 Now, I would think you would say that that
5 wouldn't prove that it was part of the worship, part of
6 worship.

7 MR. GRAETZ: No. All I would say is that
8 those kinds of fixed payments have been used by churches
9 throughout the ages, churches and synagogues.

10 There are annual dues that are required that
11 are for the year. Mass stipends have been, have been
12 permitted for private masses on an amount fixed by the
13 church.

14 Jewish synagogues charge a fixed fee for
15 tickets to enter the synagogue on High Holy Day
16 services.

17 QUESTION: Well, what's the record of the IRS
18 in that? Have they uniformly allowed those
19 deductions? Have they never been challenged? Or what
20 is it?

21 MR. GRAETZ: Well, Chief Justice, the record
22 of the IRS is in dispute. The government claims that,
23 that none of these payments had ever been passed upon by
24 the IRS. That's their position, although --

25 QUESTION: But they certainly have been

1 deducted.

2 MR. GRAETZ: They certainly have been deducted
3 and it is very hard to imagine that, that the
4 participants of that religion would have never
5 challenged in court the disallowance of those, of those
6 deductions.

7 And the administrative record here, I think,
8 contrary to the Solicitor General's brief, is really
9 quite clear. Religion has been distinguished in the law
10 of charitable trusts, which this Court has recognized to
11 be the origin of the charitable deduction provisions.

12 It was, it was made clear in a 1919 ruling
13 that the form of contribution, even fixed in amount,
14 made no difference.

15 It was reaffirmed in 1970, immediately after
16 the IRS had issued two rulings of significance in the
17 secular area, particularly involving annual dues, where
18 it said that annual dues to a secular membership
19 organization are deductible only to the excess of value,
20 but then two years later issued a ruling that said,
21 annual dues to a church are deductible, period.

22 QUESTION: Annual dues to a church?

23 MR. GRAETZ: That's what the ruling says, Your
24 Honor.

25 QUESTION: And it didn't go into any further

1 detail? Well, one doesn't ordinarily think of dues --
2 MR. GRAETZ: Well, it, it describes both of those
3 rulings, the 1919 ruling and the 1970 ruling that
4 reaffirmed that ruling, describes certain fundraising
5 practices. They describe pew rents.

6 Well, by 1970, pew rents had not been a
7 practice in the Protestant churches, but must refer to
8 the Jewish High Holy Day ticket.

9 QUESTION: But, there were pew rents in Roman
10 Catholic churches, and in some other churches.

11 MR. GRAETZ: Well, it had declined in
12 significance. But, but it was not a significant form of
13 fundraising in 1970. It was in 1919.

14 QUESTION: May I ask you to comment on the
15 government's response to, say, the, your analogy to the
16 mass stipends that, in that case and in some of the
17 others that you've mentioned, the quo, what is received
18 in exchange is not merely received by the person who
19 donates the money or contributes the money but is
20 received by the congregation at large.

21 Whereas in your situation, as I understand it,
22 the entire benefit from the contribution is by the
23 person making the contribution. Is that a valid
24 distinction?

25 MR. GRAETZ: Well, it's, it's not a valid

1 distinction, Justice Stevens, because in this religion,
2 like all religions, it is, and it is clearly in the
3 record, that this religion believes that, that the
4 proselytization and conversion of people to this
5 religion will serve mankind, in much the same way that
6 other religions do.

7 The only distinction is that these religious
8 -- this form of religious worship in this religion is
9 individual rather than congregational.

10 QUESTION: Well, that's the point. That's the
11 difference.

12 MR. GRAETZ: Well, but Your Honor, the
13 Internal Revenue code does not distinguish payments made
14 to religions based on whether they worship individually
15 or whether they worship congregationally.

16 QUESTION: Well, no, but there is a difference
17 between making a donation that benefits a large group of
18 people on the one hand, if you benefit an entire
19 congregation, and making a donation that just -- you get
20 the sole immediate benefit.

21 MR. GRAETZ: Well, but, let me give you two
22 other examples --

23 QUESTION: Let me follow up with one other
24 question I'm unclear about. Does this church have
25 physical buildings at which congregations attend church

1 in large groups?

2 MR. GRAETZ: They have, they have physical
3 buildings at which there are meetings of, of the members
4 of the faith, yes.

5 But they don't -- the congregational services
6 are not their core religious practice. Their core
7 religious practices are individual, individual
8 ritualized religious practices.

9 QUESTION: Are the group meetings attended by
10 just the general members of the church, or the
11 executives, or the hierarchy, or what are the nature of
12 the group meetings?

13 MR. GRAETZ: Well, there's not -- in the
14 record, since these payments in this case were for the
15 individualized, individual services, the record doesn't
16 get into detail about the nature of group meetings.

17 QUESTION: Does it tell us whether they have
18 any church buildings?

19 MR. GRAETZ: Yes, there are church buildings.

20 QUESTION: And they call them churches?

21 MR. GRAETZ: Yes, they do call them churches.
22 And I guess -- I really do want to follow up your first
23 point, because I do think it's crucial that, that we not
24 get into the question of whether a particular form of
25 religious worship is of relatively greater benefit to an

1 individual or to the congregation.

2 The IRS, for example, has approved tax
3 deductions for an organization that studies one family's
4 genealogy for religious purposes.

5 Now, the religion is not identified, but
6 apparently the practice described is a common Mormon
7 practice, where family genealogy is very important to
8 the baptism of the living and dead of that family.

9 And mass stipends are often, are often said --
10 masses are often said for a purpose that is specified by
11 the payor of the mass stipend. And I don't -- there's
12 nothing in the Internal Revenue Code --

13 QUESTION: Among others, among others. That's
14 not the purpose of --

15 MR. GRAETZ: Well, but in this case it's not
16 the exclusive purpose either, Justice Scalia. The
17 record is replete with, with facts that suggest that as
18 the individuals traverse the spiritual path of this
19 religion, mankind is made better off.

20 QUESTION: All these other services that
21 you've mentioned, I think it's the case, all these other
22 worships would have occurred whether the individual had
23 paid or not.

24 The High Holy service would have gone ahead
25 whether, whether a particular individual bought a ticket

1 for it, the mass would have been said whether or not
2 somebody paid to have a particular person remembered at
3 the mass.

4 It seems to me this is different in the sense
5 that, the only equivalent I can think of in, in my
6 religion at least is, is charging a fixed fee for
7 confession. There, there is something that would not
8 happen but for the fact that you paid the money to get
9 it.

10 And I think that, that is different from --

11 QUESTION: How about Mormon tithing to enter
12 the Mormon temple?

13 MR. GRAETZ: Mormon tithing -- Mormons must
14 tithe in order to enter the Mormon temple. It's a
15 requirement; it's a fixed requirement.

16 And I, I have to say, Your Honor, the
17 government --

18 QUESTION: But the temple service happens
19 anyway, whether a particular individual tithes --

20 MR. GRAETZ: Well, the government suggests
21 that the mass occurs anyway. I inquired of this, of
22 Catholic priests, because I couldn't find it in, in the
23 doctrine.

24 A Catholic priest told me that sometimes
25 masses are said for special purposes that would not

1 otherwise be said, and that are said in private, for the
2 benefit of a family in connection with, with a funeral.

3 Now, it is true that when that mass is said it
4 is said for the benefit of, of other members of the
5 faith and all mankind. But that's true in this case.

6 And I really don't think that, I don't think
7 the Internal Revenue Code permits that kind of inquiry
8 about whether this religious service would be performed
9 or would not be performed. I don't think the
10 Constitution suggests --

11 QUESTION: Well, why don't you think the
12 Internal Revenue Code permits it?

13 Certainly a lot of very intricate factual
14 inquiries are made under the code, not always with
15 statutory support.

16 MR. GRAETZ: Well, Your Honor, there's -- the
17 legislative history doesn't suggest that this is
18 appropriate. The legislative history speaks of
19 financial or monetary benefits, of monetary value
20 received in return.

21 The language contribution was, had the meaning
22 of a levy or a tax by ecclesiastical authority so that
23 there's nothing in the language of the statute that
24 suggests it. There's no case that has ever suggested
25 it, and we've got 70 years of administrative history to

1 the contrary.

2 And it seems to me that if the IRS wants to
3 start distinguishing among religions at this late date
4 in the administration of this provision of the Internal
5 Revenue Code, Congress ought to tell them to do that,
6 Congress ought to make it known that that's what they
7 want to do, and not just the IRS deciding which, which
8 churches to litigate against.

9 The problem with the IRS position in this case
10 is, there is -- they argue for a fact-bound
11 determination without ever describing what facts, what
12 rule of law is to apply.

13 They distinguish mass stipends, as Justice
14 Scalia suggests, on the grounds that it would be paid
15 anyway. They distinguish Mormon tithes on the grounds
16 that alcohol is, is prohibited. Well, alcohol in this
17 record is prohibited by the Scientologists as well.

18 They distinguish High Holy Day tickets on the
19 grounds that indigents are admitted, but you don't get
20 to deduct your payment to a parochial school because it
21 allows other people who can't afford it to come in free,
22 so that there is no coherent basis in the government's
23 position for informing religions of, of under what
24 circumstances their payments will be allowed and when
25 they will not be allowed.

1 I'd like to reserve the --

2 QUESTION: Mr. Graetz, straighten me out on
3 one thing. You have a stipulation to most of the facts
4 in this case, do you not?

5 MR. GRAETZ: Yes, Your Honor.

6 QUESTION: Is there an independent proceeding
7 having to do with the qualification of the church under
8 501(c)(3)?

9 MR. GRAETZ: Yes, there is, Your Honor.

10 QUESTION: And what is the status of that?

11 MR. GRAETZ: Well, there is an opinion that
12 has denied the status of, of the Church of Scientology
13 of California as a tax-exempt organization.

14 Those -- if the church is not tax-exempt,
15 there is no question that there are no payments
16 deductible under Section 170.

17 QUESTION: Is that a tax court opinion?

18 MR. GRAETZ: That's, that's a tax court --
19 it's a tax court opinion. It was affirmed by the 9th
20 Circuit on grounds of private inurement, and it was,
21 cert was denied in that case, so that that, that
22 particular church's tax exemption has been repealed.

23 Now in this case the petitioners made payments
24 to other churches who are recognized as tax-exempt
25 organizations in the current Internal Revenue Code.

1 QUESTION: To other Scientology churches?

2 MR. GRAETZ: Yes, Your Honor.

3 QUESTION: So you're distinguishing among
4 them?

5 MR. GRAETZ: The, the Section 501(c)(3)
6 currently distinguishes among them.

7 I'd like to reserve the balance of my time.

8 CHIEF JUSTICE REHNQUIST: Thank you, Mr.
9 Graetz. Mr. Merrill, we'll hear now from you.

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1 ORAL ARGUMENT OF THOMAS W. MERRILL

2 ON BEHALF OF THE RESPONDENTS

3 MR. MERRILL: Thank you, Mr. Chief Justice --
4 excuse me. Thank you, Mr. Chief Justice, and may it
5 please the Court:

6 The question before the Court today is whether
7 payments made by Petitioners in order to participate in
8 auditing and training sessions sponsored by the Church
9 of Scientology are deductible from gross income as
10 charitable contributions under Section 170 of the
11 Internal Revenue Code.

12 The tax court, relying on the same definition
13 of charitable contribution that this Court subsequently
14 endorsed in the American Bar -- American Bar Endowment
15 case, concluded that the payments made by the
16 Petitioners were not charitable contributions but rather
17 were purchases of auditing and training services.

18 We've heard a great deal from Mr. Graetz about
19 the facts that involve other religious denominations in
20 their fundraising practices, but I think it's
21 appropriate to begin by stressing very briefly some of
22 the facts that the tax court found in reaching that
23 particular conclusion. I take these from pages 33(a) to
24 35(a) of the petition appendix in the Hernandez case.

25 First, the tax court found that the Church of

1 Scientology charges a fixed fee for participation in
2 auditing and training sessions.

3 Next, it found that the payment of these fees
4 is a prerequisite of participation in auditing and
5 training sessions, and that with few exceptions these
6 services are never given for free.

7 In addition, the tax court found that the
8 church had a practice of offering discounts both for
9 advance payment of fees and for purchases of fees in
10 large quantities.

11 And in addition the tax court went on to find
12 that the church has an, an explicit policy of refunding
13 fees paid in advance where a request for a refund is
14 made before the services are rendered.

15 The court went on to review the extensive
16 advertising, marketing, and promotional activities of
17 the church and concluded that it operates in a
18 commercial manner in providing its religious services.

19 Specifically, the court concluded that, and
20 this is from page 35(a) of the petition appendix, the
21 goal of making money permeates virtually all of the
22 Church of Scientology's activities, its services, its
23 pricing policies, its dissemination policies, and its
24 management decisions.

25 QUESTION: Mr. Merrill, this has a little bit

1 of an other-worldly quality about it, this case, in
2 light of the 9th Circuit's holding, that the church in
3 California is not a tax-exempt organization.

4 QUESTION: Why then does the government
5 stipulate here that it is?

6 MR. MERRILL: The reason for the stipulation --

7 QUESTION: Is the government not challenging
8 the tax-exempt status of the church in other states?

9 MR. MERRILL: I'm not familiar directly with
10 the status of the tax-exempt condition of other Churches
11 of Scientology right now. I think they're probably
12 under administrative review by the Revenue Service.

13 The reason for the stipulation was an attempt
14 to resolve these cases involving the deductibility in a
15 more expeditious manner.

16 The case that counsel for Petitioners alluded
17 to involving the Church of Scientology of California
18 was, was a massive undertaking involving literally
19 millions of documents. The trial life, I've been told,
20 lasted for upwards of 50 days.

21 The tax court's opinion in that case is 144
22 pages long, and it took from 1984 to 1987 for review to
23 be completed in the 9th Circuit.

24 QUESTION: Well, did it turn essentially on
25 these same things, the marketing and advertising and

1 fixed fees and so forth?

2 MR. MERRILL: One of the issues in that
3 litigation was whether or not the Church of Scientology
4 operates for commercial as opposed to religious
5 purposes. In order to be a qualified religious
6 organization, under Section 170(c), and under Section
7 501(c)(3), the organization has to operate exclusively
8 for religious purposes.

9 And one of the contentions that the government
10 made and the tax court accepted was that the Church of
11 Scientology operated for commercial as opposed to
12 exclusively religious purposes.

13 The Ninth Circuit affirmed that decision on a
14 different ground that the church was operated for the
15 profit or benefit of specific individuals.

16 QUESTION: But you're stuck with the
17 stipulation here.

18 MR. MERRILL: That's correct, Justice
19 Blackmun. We stipulated in this case that the Church of
20 Scientology is a church under Section 501(c)(3) --
21 excuse me, is a religious organization under Section
22 501(c)(3), is a church under Section 170(b) and is a
23 qualified organization under Section 170(c).

24 The only purpose of those stipulations,
25 however, was to remove a potential legal ground for

1 denying these particular tax -- these payments,
2 tax-deductible treatment.

3 Those stipulations do not go beyond that to
4 negate any of the other stipulations in the case or any
5 of the findings of the tax court.

6 QUESTION: Mr. Merrill, do you --

7 QUESTION: But all of your troubles would have
8 been gone had you been able to follow the California
9 case.

10 MR. MERRILL: Yes. If, if, the Service had a
11 way of resolving the tax-deductible status of an
12 organization quickly, simply, and expeditiously, our
13 troubles would have been gone.

14 But because that process is, at least with
15 respect to this church, is so time-consuming and
16 burdensome, it seemed, at least at the time the
17 stipulations were made, that it would be quicker to
18 stipulate to that particular --

19 QUESTION: But are these churches so
20 different? After all, there are various Lutherans
21 synods, too. And --

22 MR. MERRILL: They're not really that
23 different. In fact, I think there's testimony in the
24 joint appendix to the effect that they all operate
25 essentially the same.

1 The problem is, I understand, that in
2 determining the tax-exempt status of an organization for
3 170(c) purposes or 501(c)(3) purposes, the Service has
4 to proceed organization by organization and year by
5 year, and it can't render a, a broad-scale prospective
6 determination that would apply to different,
7 technically-distinct organizations in future years and
8 resolve whether or not they are eligible for tax-exempt
9 treatment because these organizations obviously could
10 change.

11 QUESTION: Do you also agree that the
12 synagogue sell their seats on High Holy Days and the
13 Catholic churches sell their seats at a fixed price? I
14 emphasize fixed price.

15 MR. MERRILL: Justice Marshall --

16 QUESTION: Do you admit that?

17 MR. MERRILL: Justice Marshall, we don't admit
18 anything about the practices of churches that are not
19 involved in this particular case.

20 QUESTION: Why not? You don't know?

21 MR. MERRILL: Because there's nothing in the
22 record about the actual --

23 QUESTION: You don't know? Is that the
24 reason? Or are you refusing to admit something that you
25 know?

1 MR. MERRILL: No. No, Justice Marshall, we're
2 not refusing to admit something that we know.

3 What has happened here is that the Petitioners
4 have made a kind of administrative consistency argument
5 which is based not on anything that the Internal Revenue
6 Service has decided, or any reported decisions, but is
7 based on treatises, articles, and secondary sources that
8 describe the practices of these other religions.

9 QUESTION: Well, let me put it specifically.
10 Does IRS grant relief to the people that buy seats in
11 the synagogues and the Catholic churches?

12 MR. MERRILL: I do not know the answer to that
13 question, Justice Marshall.

14 QUESTION: Sir?

15 MR. MERRILL: I do not know the answer to that
16 question. There is nothing in the record, and I know
17 nothing about the practice of the Revenue Service, to
18 know what happens if somebody submits a claim that a
19 purchase of a high holy seat is --

20 QUESTION: You know, it's really possible that
21 some of us do know.

22 QUESTION: Mr. Merrill, would you at least
23 agree that if your position is correct, that some
24 deductions for other religious practices and payments
25 might be called into question?

1 MR. MERRILL: I would agree --

2 QUESTION: Such as Mormon tithing and some of
3 the other things that go on.

4 MR. MERRILL: Well --

5 QUESTION: I mean, would you at least concede
6 that those practices then would be open to question for
7 their deductibility?

8 MR. MERRILL: Yes. Justice O'Connor, I think
9 the important point is this, and it's been obscured
10 considerably by the Petitioners' presentation.

11 The Revenue Service in this case, the tax
12 court in this case, the Ninth Circuit and the First
13 Circuit, applied a well-established standard for
14 determining whether or not a payment is tax-deductible
15 that applies to all types of charitable organizations.

16 That standard is basically the quid pro quo
17 inquiry asking whether or not payment was made without
18 any expectation of a commensurate benefit or return
19 consideration.

20 That is the standard that the Service will
21 apply to any other church's fundraising practices in
22 determining whether or not they are tax-deductible.

23 If some religion comes across -- comes forward
24 that in fact charges admission, as a condition for
25 attendance at its religious services, then there would

1 be a significant risk that that religion would also be
2 treated as not eligible for tax-deductible
3 contributions. At this point in time that has not
4 happened.

5 QUESTION: It is difficult, isn't it, to place
6 a value on religious worship --

7 MR. MERRILL: Not in this case.

8 QUESTION: In the quid pro quo context?

9 MR. MERRILL: Not in this case. Because the
10 Petitioners themselves have placed a value. They have
11 charged fixed prices as a prerequisite for attendance at
12 these services.

13 QUESTION: Well, but you can say that also in
14 response to a 10 percent tithing requirement or
15 membership requirement of any kind. You can say the
16 parties have placed a value on it.

17 MR. MERRILL: That's true, although with
18 respect to something like mandatory tithing what is
19 being offered there is membership in a church, not
20 participation in discrete religious services.

21 And I think that would be an important
22 distinction that the Service would take into account in
23 deciding whether something like a mandatory tithing
24 requirement was eligible for tax-deductible treatment.

25 I think that a, a mandatory fee or tithing

1 requirement for membership in a church doesn't have the
2 same kind of close, one-on-one connection, causal
3 connection, between the payment of the fee and the
4 provision of the services that you have in this
5 particular case.

6 Membership in the church might entail the
7 right to, to participate in all types of different
8 services, some of which would be exercise, some of which
9 would not be. It also would entail, I presume,
10 significant obligations.

11 QUESTION: But Mr. Merrill, it has the very
12 precise quid pro quo. For the tithe you get to be a
13 member of the church.

14 Why isn't that precisely the kind of quid pro
15 quo that would make it non-deductible under your
16 reasoning?

17 MR. MERRILL: Well, the quid pro quo that the
18 Service is focusing on here is, is the provision of, of
19 specific services that inure to the benefit, primary
20 benefit, of the individual making, making the particular
21 payment.

22 QUESTION: Whatever, whatever appertains to
23 membership in the church is precisely what you get for
24 your tithe. You don't get anything else.

25 I don't understand your argument. It seems to

1 me you made a rather extreme concession.

2 MR. MERRILL: I, I don't think so, Justice
3 Stevens, because again membership in an organization
4 does not necessarily involve some kind of discrete
5 package of benefits or services. It could. And if it
6 did perhaps you would have a situation quite analogous
7 to this case.

8 But the Service has --

9 QUESTION: I just simply don't understand
10 that. I think a member of whatever the organization is,
11 a member has certain privileges as a result of being a
12 member.

13 He's eligible for certain offices, he can do
14 certain things that he cannot do if he's not a member.
15 What -- otherwise why would anyone want to be a member?
16 If you have to -- you can be a member of the Catholic
17 church or most churches without paying anything. You
18 just walk in the front door and start attending
19 services.

20 MR. MERRILL: Well, in looking at membership
21 dues and fees in general, for all types of charitable
22 organizations, as well as religious organizations, the
23 Service has tended to ask whether or not membership
24 entails discernible concrete benefits, privileges of
25 admission, for example, to certain types of activities

1 that would have a value.

2 And the Service has also said that if
3 membership simply has, simply confers a status on an
4 individual, a certain honorific-type status for example,
5 that -- in that situation the benefit, although I will
6 admit that there technically is a benefit there, is
7 considered to be incidental. That's a legal conclusion.

8 And when there's an incidental benefit it's
9 been determined that that doesn't disqualify the person
10 from deducting the membership dues as a charitable
11 contribution.

12 QUESTION: Well, if you can't get in the
13 temple without paying the Mormon tithing, then that
14 would be enough certainly, and I'm sure that that's the
15 condition, to be a Mormon in good standing, and
16 therefore to be able to gain admittance to the temple.

17 MR. MERRILL: I'm not -- I didn't follow the
18 question. You're saying that --

19 QUESTION: I mean, there is at least one, one
20 thing other than just honorific membership, other than
21 just status that comes from a Mormon tithe, and that is
22 admission -- being able to get admitted to the temple.

23 MR. MERRILL: If, as has been suggested, in
24 the sources the petition has referred to, there is
25 mandatory requirement of payment of tithes as a

1 condition to entry into the services, that distinguishes
2 that case somewhat from the ordinary case of church
3 dues.

4 QUESTION: So tithes, tithes may well be out.
5 It's too bad, they've been around a long time.

6 MR. MERRILL: Well, tithing --

7 QUESTION: Longer than pew rents even.

8 MR. MERRILL: Again, tithing practices vary
9 quite widely among religions. And even in the Mormon
10 Church we have a situation that's considerably
11 different, I think, from the one presented by this
12 particular case.

13 QUESTION: What is the controlling principle
14 that, that means these particular contributions or
15 payments are not deductible but others on the other side
16 are? It isn't just the fixed amount, is it?

17 MR. MERRILL: No. It's not just the fixed
18 amount, although that's a very critical element in the
19 determination.

20 The controlling principle which was cited by
21 all the lower courts, and is no great mystery is that
22 the Service asks whether or not the payment is made
23 voluntarily with the expectation of not receiving a
24 commensurate benefit or consideration in return.

25 And in deciding that question --

1 QUESTION: An earthly consideration, I take
2 it.

3 MR. MERRILL: Well, something which is, which
4 is observable and measurable, yes. Something like the
5 right to attend auditing sessions and training
6 sessions.

7 And in answering that question the Service
8 looks at a variety of facts. The tax court enumerated a
9 number of the facts that it thought were particularly
10 critical in reaching the conclusion that in fact that
11 type of quid pro quo arrangement was present here,
12 rather than, rather than the intention of making a
13 gift.

14 QUESTION: Excuse me, it has to be observable
15 and measurable. So you could still sell indulgences
16 then, right, if you get an indulgence at--

17 MR. MERRILL: I think indulgences --

18 QUESTION: -- a hundred dollars a shot, it's
19 not observable or measurable; that would not be a quid
20 pro quo.

21 MR. MERRILL: I think we won't have to face
22 that since indulgences were abolished in 1567, according
23 to the Petitioners' brief.

24 But I think indulgences would present a
25 slightly different question in this respect. The quid

1 pro quo analysis, I take it, looks at payments made to a
2 Section 170(c) organization and some benefit that is
3 conferred in return by the Section 173(c) organization.

4 In this particular case the fixed payments
5 that are paid to the Church of Scientology, and in
6 return the opportunity to attend auditing sessions with
7 the auditor and the emir and so forth or training
8 sessions.

9 In the case of indulgences, the return
10 consideration is not coming so much from the church as
11 it's coming from a non-temporal realm, and in that
12 particular -- in that type of situation we think that
13 you might not have the same type of quid pro quo
14 analysis.

15 QUESTION: Don't you feel uncomfortable
16 drawing these lines in the supernatural area?

17 MR. MERRILL: I do, I do, Justice Scalia. And
18 I don't think it's necessary to decide all these issues
19 in this particular case. Certainly none of the lower
20 courts have felt compelled to.

21 And I think that it's important that, that the
22 particular practices of other religions that have not
23 been examined by either the Service or the tax court not
24 be determined to be either deductible or non-deductible
25 based on "evidence" from secondary sources, some of

1 which is quite obscure and quite outdated.

2 QUESTION: I know, but they may well be
3 controlled by the kind of test we apply, and I'm not
4 sure your test doesn't clearly apply to the practice of
5 the selling tickets for High Holy Days, if that's -- in
6 the temple, as described at least in the other brief.

7 Maybe it should, I don't know. But it's --

8 MR. MERRILL: We're not saying that it would
9 or would not apply to practice for High Holy Days. I
10 mean, I think that's an excellent example of why it's
11 important not to prejudge the nature of religious
12 practices without having an actual record which shows
13 what they are.

14 It would be relevant, I think -- the Service
15 would want to know whether or not the purchase of High
16 Holy Day tickets is a prerequisite of admission to the
17 service or whether there is simply determined seating
18 within the service, whether or not everyone has to have
19 a ticket to get in or whether or not exceptions or made
20 for persons of reduced means.

21 QUESTION: Well, would any of those facts make
22 any difference under your view of the law?

23 MR. MERRILL: Yes. They might.

24 QUESTION: They might or they would? I mean,
25 what difference does it make if you get a particular

1 seat or just get in the temple?

2 MR. MERRILL: Well --

3 QUESTION: In either event you had to pay to
4 get the particular --

5 MR. MERRILL: There is a quid pro quo involved
6 in the payment to obtain a particular seat. I think --

7 QUESTION: Isn't there also a quid pro quo, a
8 payment to get inside the temple, if they won't let you
9 in otherwise?

10 MR. MERRILL: Technically speaking there is.
11 In the 1919 revenue ruling, in fact, the Treasury
12 stated, is very cryptic, only two short paragraphs
13 long.

14 But it stated very cryptically that, that from
15 a technical angle one could distinguish pew rents. And
16 I think what was meant by that was that there was this
17 quid pro quo element that you were paying for a
18 particular seat.

19 But then they went on to say that they thought
20 that this benefit was conjectural, that it was, that
21 whether or not there was personal accommodation here was
22 conjectural, noted that frequently the same type of
23 accommodations made in an informal basis to people that
24 give basket contributions, and decided that therefore
25 that ordinarily and customarily the intent was probably

1 -- the real intent, was probably to make a contribution
2 rather than to purchase that particular element.

3 I think it's important before getting drawn
4 too far into these discussions of other practices not to
5 lose the big picture here.

6 And I think the big picture is that the
7 Petitioners are arguing for a special rule, a special
8 exemption that would apply only to one type of purchase
9 of services, religious services, and that would in
10 effect make any purchase of religious services per se
11 deductible.

12 We think that there are a number of very
13 serious problems with this approach to interpretation of
14 Section 170, and let me try to list those just briefly
15 for the Court's consideration.

16 First, there's no way to reconcile the
17 Petitioners' proposed special rule with the language of
18 Section 170.

19 Section 170 establishes one standard, and only
20 one standard, for determining when a deductible
21 charitable contribution has been made to any type of
22 qualifying charitable organization, whether it's engaged
23 in religious, charitable, scientific, literary, or
24 educational activities.

25 The standard requires that in order to be

1 deductible, a payment must be a contribution or gift.
2 And what Petitioners are proposing, in effect, is to
3 read the gift requirement out of the statute with
4 respect to one type of services, religious services.

5 Second, the fact that religious activities
6 provide a subjective and intangible benefit that can't
7 be directly valued doesn't differentiate religious
8 services from other types of activities that are offered
9 by charities.

10 Poetry readings, concerts, private exhibitions
11 of art, all have a very highly subjective and tangible
12 value to the participant, and there may be no equivalent
13 service in the marketplace that can be used to fix a
14 value of these particular services.

15 Nevertheless, it's well-established in the
16 Service's revenue rulings that when a charity sets a
17 fixed admissions charge for something like a poetry
18 reading or a private exhibition, and makes payment of
19 that charge a prerequisite of attendance, the price of
20 the fee is presumed to be equal to the value of the
21 services received and hence is non-deductible.

22 Third, the special rule that Petitioners urge
23 would in our view aggravate rather than alleviate
24 potential First Amendment concerns.

25 Under the gift or contribution standard

1 reflected in Section 170, the deductibility of a payment
2 to a church is determined by a secular standard, whether
3 there was an intention to make a gift rather than a
4 purchase of services.

5 But under the special rule that the
6 petitioners are arguing in favor of, the only possible
7 inquiry that could be made by the Service is whether or
8 not the church is providing bonified religious
9 services.

10 The intrusion and entanglement that would be
11 involved in conducting that inquiry would far exceed
12 anything that would be presented by looking at the
13 external form or structure of the transaction to see if
14 the payment is a quid pro quo for the provision of
15 services.

16 QUESTION: Well, Mr. Merrill, I think they're
17 really just arguing that the IRS has interpreted it that
18 way for religious services all these years.

19 MR. MERRILL: That is their primary argument.

20 QUESTION: And they're saying, why don't --
21 why should we follow a different rule here? And I think
22 you have to concede that certainly the IRS ruling back
23 in 1919 and subsequent practice lends some credence to
24 that argument.

25 MR. MERRILL: I'm afraid we don't concede

1 that, Justice O'Connor. It's a very curious argument.

2 If you look at these revenue rulings that are,
3 that are cited by the Petitioners, you will not see any
4 reference to the proposition that any payment for the
5 provision of religious services is deductible
6 automatically, or any equivalent language.

7 You will not see any reference to a
8 distinction between secular services and non-secular
9 services. You will not see any comment to the effect
10 that any provision of religious services is always
11 incidental in the legal sense.

12 In fact, if you look at something like the
13 1919 revenue ruling, what you will find is that the
14 Service was applying the same standard that was applied
15 in this particular case.

16 What the Service asked in that particular case
17 was whether the real intent was to contribute to the
18 church or to hire a seat or a pew for personal
19 accommodation.

20 That's the same distinction that we're being,
21 asking the Court to apply here, the distinction between
22 a gift or contribution and a purchase.

23 The 1970 revenue ruling was simply an attempt
24 to update the 1919 revenue ruling. There had been a
25 change in statutory provisions and so forth. There's no

1 analysis in that whatsoever.

2 The other revenue ruling, which is more or
3 less on point, has to do with mass stipends, and that
4 was a 1978 revenue ruling, which made quite clear that
5 the facts that were presented in that case involved a
6 mass that would have been said in any event and a mass
7 that was open to the general public.

8 And the conclusion it reached was that in most
9 circumstances the payment of the mass stipend was
10 incidental and was not something that would not be
11 deductible.

12 QUESTION: I guess we'd feel more comfortable
13 if you had gone after some churches and synagogues.

14 MR. MERRILL: Well, it may simply be, Justice
15 Scalia, that -- I mean, there may be, there may be
16 several reasons why there aren't more reported cases
17 directly involving religious services.

18 It's difficult to pick up these things on
19 audit. All you've got is, is the listing of a gift to a
20 church and cancelled check payable to the church.

21 In addition, I don't think it's quite true,
22 it's certainly not true in the sense that the
23 petitioners argue that there is no analogous precedent
24 that supports the proposition that payments for
25 religious services are not deductible.

1 And I think that the religious education cases
2 are particularly instructive here, and much more
3 instructive than the Petitioner lets on.

4 QUESTION: Mr. Merrill --

5 MR. MERRILL: Yes.

6 QUESTION: When was this point first raised in
7 this particular area?

8 MR. MERRILL: Which point, Justice --

9 QUESTION: About these synagogues and Roman
10 Catholic churches selling seats. That was raised in the
11 beginning of this case, wasn't it?

12 MR. MERRILL: I'm not sure when the reference
13 to other religious practices crept into the litigation --

14 QUESTION: Well, about how many years ago was
15 it?

16 MR. MERRILL: In this particular -- there is
17 some reference to this argument in the First Circuit's
18 opinion in this case.

19 I don't recall any reference to it --

20 QUESTION: How long ago was that? Because my
21 second answer's going to be, what have you done about
22 it?

23 MR. MERRILL: The First Circuit's opinion --

24 QUESTION: Outside of this case?

25 MR. MERRILL: I believe, is 1987.

1 QUESTION: Well, what has the Internal Revenue
2 done about it, the Service?

3 MR. MERRILL: I have -- I don't know that the
4 Internal Revenue has done anything, Justice Marshall,
5 because we don't think that, as I've been explaining to
6 Justice O'Connor, we don't interpret our regulations as
7 being inconsistent with the position that was taken in
8 this particular case. They are simply applications of
9 the same position that we're taking here.

10 I think it's important to realize the
11 argumentative strategy that the Petitioners adopted
12 here. The tax court relied upon a whole list of
13 factors, factual findings, that were strongly indicative
14 of an intention to purchase services rather than to make
15 a gift.

16 And what Petitioners have done is they've gone
17 down each particular one of those factors and said, oh,
18 but wait, we can point to another religion that has a
19 practice somewhat analogous to that particular element.
20 And then they say, as to the next factor, well, but
21 wait, there's yet another religion that has another
22 factor like that.

23 But what they haven't done is point to anyone
24 who has all of the features, or anything even close to
25 the features, that are presented by the Church of

1 Scientology in this case.

2 They haven't pointed to a case where a church
3 is selling admission tickets at the door in order to
4 attend religious services. If such a case did exist,
5 and, and had been decided differently, then there might
6 be a problem of administrative consistency.

7 Let me go back just quickly to the point about
8 religious education, because I think it's important.
9 It's well-established that tuition payments for
10 education are not deductible, it's established that that
11 applies to a completely sectarian as well as
12 non-sectarian church school.

13 No distinction is made as to whether or not
14 the educational instruction serves as a substitute for
15 ordinary schooling or whether it takes place in the
16 church.

17 And finally, and I think this is the truly
18 critical point, although virtually all the parochial
19 school cases that are cited by Petitioners have involved
20 the provision of purely religious services, as well as
21 educational services, there has never been a suggestion
22 made that there should be some apportionment between the
23 component that reflects the education and the component
24 that reflects the religious services.

25 There has been apportionment in those cases,

1 but it's apportionment between the amounts of
2 contributions and the costs, without any differentiation
3 between the costs of the education and the costs of the
4 religious services.

5 And the fact that deductions have been
6 disallowed for the religious service component of those
7 cases, I think, does offer substantial support for the
8 proposition that there's nothing radical or untoward
9 about the position that the commissions take in this, in
10 this case, positions taken in this case that religious
11 services should be subject to the same general standard,
12 the same quid pro quo analysis that all types of
13 payments are made under Section 170 of the Code.

14 If the Court has no further questions, thank
15 you.

16 CHIEF JUSTICE REHNQUIST: Mr. Graetz, you have
17 four minutes remaining.

18 REBUTTAL ARGUMENT OF MICHAEL J. GRAETZ
19 ON BEHALF OF THE PETITIONER

20 MR. GRAETZ: May it please the Court. I --
21 I'd just like to make three points, if I could.

22 One is, Your Honor, that the comparison to
23 other religions' fundraising practices appears in the
24 tax court testimony of the expert witness and was
25 uncontradicted, and I refer you to page 84 of the joint

1 appendix for that testimony.

2 So it was not something that was not in the
3 record below, and each of the appellate courts that has
4 decided a case here has recognized that there is a
5 threat to the practices of other religions.

6 Secondly, in response to the question, what is
7 the controlling principle here that the Chief Justice
8 asked, what the government is doing is denying the
9 existence of the controlling principle in all other
10 contexts.

11 The controlling principle in all other
12 contexts is the relationship of the amount of the
13 payment to the value of what is received in return, and
14 the government concedes, apparently, that you can't
15 value religious services.

16 And that was the point that was made by the
17 Second Circuit, the Sixth Circuit, and the Eighth
18 Circuit in finding for the taxpayers here, and without
19 the ability to value then there is no standard here,
20 there is just a, a, a selection of facts.

21 And the government's argument makes that
22 absolutely clear, and the prices that are set here, the
23 tax court found, are based on average family income, and
24 they're not in any way a measure of the value of the
25 services.

1 There's a footnote in the tax court opinion
2 that points out that these auditing fees are based on
3 the average family income in the district.

4 Third, Your Honor, it seems to me that the
5 government has now made it clear that their problem here
6 is that it's just too cumbersome under the Internal
7 Revenue Code to litigate the tax exemption of
8 organizations.

9 And, and if that's the problem, if that's why
10 they've made this dramatic change in their position,
11 then they should be at Congress. If there's a problem
12 in enforcing the provisions of Section 501(c)(3), then
13 Congress is the appropriate body to, to address that
14 problem.

15 Commercialism, and the role of commercialism,
16 is an extremely complicated question under Section
17 501(c)(3).

18 The tax court finding here in the court below,
19 on the tax exemption case, is a unique finding. It was
20 not affirmed on appeal. The court did not reach that
21 issue in the Ninth Circuit appeal.

22 And as Judge Jones said in the Sixth Circuit,
23 the fact that the government has stipulated that this is
24 a tax-exempt church means under the regulations that
25 only an insubstantial amount of its function can be

1 devoted to a non-exempt purpose.

2 So that there is, the stipulation itself means
3 that commercialism is irrelevant here, it's
4 insubstantial by definition, by stipulation. And that's
5 why Judge Jones said that the finding of the tax court
6 that this court operates in a commercial fashion is
7 irrelevant and not controlling.

8 There is no instance, there is no instance --

9 QUESTION: Neither of these cases came from
10 the Sixth Circuit, did it?

11 MR. GRAETZ: The cases that are before this
12 Court today are appeals from the First and, and Ninth
13 Circuit.

14 QUESTION: So why are you quoting a judge in
15 the Sixth?

16 MR. GRAETZ: Well, there were identical cases
17 in the Sixth Circuit, cases exactly like Hernandez --
18 there's a split in the circuits.

19 The First and Ninth Circuit, along with the
20 Fourth Circuit and the Tenth Circuit, have found for the
21 government. The Second, Sixth, and Eighth Circuits, on
22 records identical to the Hernandez case here, have found
23 for the taxpayer.

24 QUESTION: Well, then you are saying that all
25 the Scientology Churches are alike.

1 MR. GRAETZ: Your Honor, I'm not saying that.

2 In fact, there is, there is an exemption certificate,
3 and it's in the list of cumulative organizations that
4 are exempt, for certain Scientology Churches.

5 The Church of Scientology of Hawaii, which is
6 the church to which Ms. Graham made her payments, is
7 tax-exempt. There are other churches in Scientology
8 that have held not to be tax-exempt.

9 That's the way the government should proceed
10 with this issue.

11 CHIEF JUSTICE REHNQUIST: Thank you, Mr.
12 Graetz. The case is submitted.

13 (Whereupon, at 2:47 o'clock p.m., the case in
14 the above-entitled matter was submitted.)
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CERTIFICATION

Alderson Reporting Company, Inc., hereby certifies that the attached pages represents an accurate transcription of electronic sound recording of the oral argument before the Supreme Court of The United States in the Matter of:

No. 87-963 - ROBERT L. HERNANDEZ, Petitioner V. COMMISSIONER OF INTERNAL REVENUE: and

No. 87-1616 - KATHERINE JEAN GRAHAM, ET UX., Petitioners V. COMMISSIONER OF INTERNAL REVENUE

and that these attached pages constitutes the original transcript of the proceedings for the records of the court.

BY Judy Freilicher
(REPORTER)

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