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Should Payments to a Church for Participation in Religious Practices Be Tax Deductible

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Comments

Should Payments to a Church for Participation in Religious Practices be Tax Deductible?

I. INTRODUCTION

In 1972 Katherine Graham, a member of the Church of Scientology,\(^1\) made payments to the Church in the amount of $1,682.\(^2\) Graham’s payments entitled her and her children to participate in auditing and training sessions conducted by the Church. These are forms of one-to-one counseling which are the central religious exercise of the Church. Graham and her children participated in the sessions and Graham claimed a charitable contribution of $1,682 on her 1972 federal income tax return.\(^3\) Maureen Staples and Robert Hernandez, also members of the Church, also made payments to the Church for auditing and training\(^4\) and, like Graham, participated in the sessions. They, like Graham, claimed a charitable contribution on their federal income tax returns.\(^5\) The Internal Revenue Service (IRS) disallowed the claimed deductions of all three taxpayers.\(^6\) The IRS determined that the payments were not contrib-

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1. *See infra* note 51 and accompanying text.
4. Staples v. Commissioner, 821 F.2d 1324, 1325 (8th Cir. 1987); Hernandez v. Commissioner, 819 F.2d 1212, 1215 (1st Cir. 1987).
5. *Staples*, 821 F.2d at 1325; *Hernandez* 819 F.2d at 1215.
6. *Graham*, 83 T.C. at 581; *Staples*, 821 F.2d at 1328; *Hernandez*, 819 F.2d at 1227. (Staples and Hernandez agreed to be bound by the stipulations in *Graham*. *Staples*, 821 F.2d at 1325.)

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butions, but rather were payments made for services. The taxpayers petitioned the United States Tax Court to review the IRS decisions.

The tax court agreed with the IRS that the payments were not charitable contributions within the meaning of Section 170(c) of the Internal Revenue Code. Instead, the payments were nondeductible personal expenditures for services rendered. Graham appealed to the Court of Appeals for the Ninth Circuit to overturn the decision of the tax court. Staples made the same appeal to the Eighth Circuit and Hernandez appealed to the First Circuit. On June 1, 1987, the First Circuit affirmed the tax court in the case of Robert Hernandez. One month later, on July 1, 1987, the Eight Circuit reversed the tax court by holding that Staples' payments were a contribution within the meaning of section 170. Sixteen days later the Ninth Circuit affirmed the tax court by holding that Graham's payments were not a contribution within the meaning of section 170.

Appeals parallel to those of Graham and Staples have been initiated in every circuit of the court of appeals, except the Federal Circuit. The First, Fourth and Ninth Circuits have joined in rejecting the contention that the payments constitute charitable contributions. The Eighth Circuit stands alone in its holding that the payments are contributions. The Graham and Staples decisions present two very different approaches for determining what constitutes a charitable contribution. The purpose of this Comment is to review and evaluate the legal and analytical foundations of these inconsistent decisions. This Comment will conclude that the decision of the Eighth Circuit Court of Appeals to allow a charitable contribution deduction is not in accord with the intent of Congress, nor is it consistent with judicial precedent.

Section 170 of the Internal Revenue Code provides the statutory basis for the charitable contribution deduction. Section 170(a) allows "as a deduction any charitable contribution (as defined in subsection (c)) payment of which is made within the taxable year." Section 170(c) cryptically defines a charitable contribution as "a contribution or gift to or for the use of ... [a] corporation, trust, or commu-

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9. Hernandez, 819 F.2d at 1227.
10. Staples, 821 F.2d at 1328.
11. Graham, 822 F.2d at 850.
13. See, e.g., Hernandez, 819 F.2d 1212; Miller, 829 F.2d 500; Graham, 822 F.2d 844.
14. See Staples, 821 F.2d 1324.
15. I.R.C. § 170(a)(1) (1988) (The I.R.C. has permitted taxpayers to deduct contributions to designated non-profit organizations since 1917. Section 170 was enacted in 1954. See Miller, 829 F.2d at 502.).
nity chest, fund, or foundation . . . organized and operated exclusively for religious, charitable, scientific, literary, or educational purposes. . . ."\textsuperscript{16} The Treasury Regulations provide no further definition of either the term contribution or gift.\textsuperscript{17} The absence of a clear congressional definition has left the courts with the task of defining the limits of deductibility under section 170.\textsuperscript{18}

In 1986 the Supreme Court decided \textit{United States v. American Bar Endowment}.\textsuperscript{19} The Court was faced directly with the task of defining the standard for determining when a payment is a charitable contribution. The Supreme Court held that a taxpayer "must at a minimum demonstrate that he purposely contributed money or property in excess of the value of any benefit he received in return."\textsuperscript{20} By this holding the Court has adopted a two-pronged test that the taxpayer must satisfy before the taxpayer may deduct a payment as a deduction. The taxpayer must demonstrate that the payment exceeded the value of any return benefit and the taxpayer must demonstrate that the excess payment was made with the intention of making a gift. \textit{American Bar Endowment} established the legal standard defining the limits of the charitable contribution.\textsuperscript{21} The Supreme Court left the IRS and trial courts with the task of making the factual determinations as to the value of the return benefit and the subjective intentions of the taxpayer.\textsuperscript{22}

It was one year after \textit{American Bar Endowment} that the Court of Appeals for the Ninth Circuit denied Katherine Graham's deduction. The \textit{Graham} court stated that "[t]he rule in this circuit is that a charitable gift or contribution must be a payment made for detached and disinterested motives. This formulation is designed to ensure that the payor's primary purpose is to assist the charity and not

\textsuperscript{16} I.R.C. § 170(c)(2)(B).
\textsuperscript{17} See Treas. Reg. § 1.170-1 (as amended in 1972).
\textsuperscript{18} See \textit{Miller}, 829 F.2d at 502 ("[T]he Internal Revenue Code . . . [has] never defined the term 'contribution or gift."); see also \textit{DeJong v. Commissioner}, 309 F.2d 373, 377 (9th Cir. 1962), aff'd, 36 T.C. 896, 899 (1961); see generally \textit{Hobbet, Charitable Contributions - How Charitable Must They Be?}, 11 SETON HALL 1 (1980).
\textsuperscript{20} 477 U.S. at 118.
\textsuperscript{21} \textit{Hernandez}, 819 F.2d at 1216 ("Our analysis of this question is framed by the Supreme Court's recent interpretation of the scope of the charitable contribution deduction. . . .")
\textsuperscript{22} See \textit{American Bar Endowment}, 477 U.S. at 118; see also \textit{Commissioner v. Duberstein}, 363 U.S. 278, 289 (1960).
to secure some benefit personal to the payor." The *Graham* court stated "[w]e think this approach is a proper approach and find it in full accord with the Supreme Court's recent opinion in *United States v. American Bar Endowment.*" In the same month, the Eighth Circuit held that Maureen Staples' participation in auditing was "not a recognizable return benefit under section 170, [and therefore] the analysis of *American Bar Endowment* by its very nature was inapplicable to the situation. . . ." In June 1987, the First Circuit directly applied the *American Bar Endowment* two-pronged test and denied the claimed deductions of scientologist Robert Hernandez.

The First Circuit directly applied *American Bar Endowment*; the Ninth Circuit followed *American Bar Endowment* but applied a different legal standard; and the Eighth Circuit distinguished the *American Bar Endowment* analysis. Because each of these decisions was based on the same code section, the same precedent and the same facts, the inconsistent outcomes cannot be reconciled. If one accepts deductibility according to *Staples*, then one must reject the decision of *Graham*, and vice versa.

II. THE SUPREME COURT'S TWO-PRONGED TEST FOR DEDUCTIBILITY

The Supreme Court decided *United States v. American Bar Endowment* in 1986. This was the first time the high court had addressed the issue of deductibility under Internal Revenue Code section 170. The decision was binding precedent on each of the courts of appeals which decided the scientologist cases. Any meaningful analysis of the scientology decisions must be done in the light of *American Bar Endowment*; the following key elements of that decision are presented as background.

The American Bar Endowment (ABE) is a charitable organization exempt from taxation under section 501(c)(3) of the Internal Revenue Code. The ABE promotes legal research and education in

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25. *Staples*, 821 F.2d at 1328.

26. *Hernandez*, 819 F.2d at 1218 ("[W]e conclude that Hernandez has failed to shoulder the burden assigned by the Supreme Court." (footnote omitted)).

27. *American Bar Endowment*, 477 U.S. at 107. The recipient organization must meet this requirement in order to entitle the contributing taxpayer to take a charitable deduction. It should be noted that the IRS has challenged, and the tax court has ruled, that the Church of Scientology does not qualify as a tax exempt organization. *Church of Scientology v. Commissioner*, 83 T.C. 381, 443 (1984). In the *Graham*, *Staples*, and *Hernandez* cases the government stipulated that the Church was qualified under I.R.C. § 501(a). *Graham*, 822 F.2d at 846; *Staples*, 821 F.2d at 1325; *Hernandez*, 819 F.2d at 1216.
order to advance the administration of justice. All members of the American Bar Association are automatically members of the ABE, but the ABE is a separate legal entity. The ABE raises money for its charitable works by providing group life, health, accident and disability insurance policies to its members. These policies are underwritten by insurance companies. All of the ABE insurance plans are participating plans. This type of plan offers the possibility that dividends may be refunded to the insured members (insureds) at the end of each year based on the premiums collected and the claims paid. Although the dividends would normally be paid to the insureds, members of the ABE are required by the ABE to assign these dividends to the ABE as a condition for participating in the insurance plan. These dividends are used by the ABE for its charitable purposes.  

Four individual members of the ABE claimed a charitable contribution deduction for the dividend refunded on their behalf by the insurance companies to the ABE. The four individual actions were consolidated by the claims court to determine if the ABE members were entitled to a charitable deduction for a portion of their premiums paid. The taxpayers urged the theory that the premiums paid represented a dual payment – part for insurance and part as a contribution to the ABE’s charitable activities.  

The procedural history of American Bar Endowment illustrates the confusion of the lower federal courts in determining what was a section 170 contribution. The claims court cited a 1967 revenue ruling as authority for the proposition that a single payment could have dual characteristics. The court then relied on the same revenue ruling to support its decision that the ABE members had failed to demonstrate that they bought goods or services for more than their economic value, with the intention that the excess be used to benefit a charity. Thus, the claims court denied the deductions. 

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30. Id. at 414.  
31. See generally Hobbet, supra note 18.  
32. American Bar Endowment, 4 Cl. Ct. at 415 (citing Rev. Rul. 68-4432, 1968-2 C.B. 104 and Rev. Rul. 67-246, 1967 C.B. 104-105.) These revenue rulings address the issue of deductibility of payments when the payor receives a benefit in return. These rulings recognize that admission to a charitable fund raising event and membership in a charitable organization are return benefits.  
33. American Bar Endowment, 4 Cl. Ct. at 415 (citing to Rev. Rul. 67-246, 1967-2 C.B. 104, 105.) It is helpful to note that the IRS applied, in this 1967 ruling, the two-pronged standard for deductibility which the Supreme Court would adopt almost twenty years later in American Bar Endowment.  
34. Id. at 418.
On appeal, the Federal Circuit Court of Appeals held that "well established principles of tax law from this circuit and elsewhere require that we reject the unitary approach of the court below..."35 The Federal Circuit first stated that the test applied by the claims court placed too harsh a burden on taxpayers by requiring them to prove a charitable motivation of disinterested generosity.36 Second, the Federal Circuit stated that the claims court's "overly-precise formulaic test" assumes that all persons are economic persons acting solely on a careful and detailed comparative investigation of pecuniary results.37 The court noted that in life, an intention to enter into a charitable transaction is often intertwined with other motivations, including some that are non-charitable. The Federal Circuit posed the issue as whether the transaction was of a business or a charitable nature.38 The court noted that the record was bare as to the nature of the dealings between ABE and its members and, therefore, the court reversed and remanded for further proceedings to determine whether the nature of the relationship between the ABE and its members was predominantly of a business nature or whether the transaction had a substantial charitable component.39

The Supreme Court granted certiorari, and upon review, held that the claims court had applied the proper standard.40 "The sine qua non of a charitable contribution is the transfer of money or property without adequate consideration. The taxpayer, therefore, must at a minimum demonstrate that he purposely contributed money or property in excess of the value of any benefit he received in return."41 Thus, the holding of American Bar Endowment placed the burden on the taxpayer to prove two elements — intent to make a gift and excess value over that received in return.42 Applying this standard, the Court affirmed the claims court decision to deny the tax deduction for each of the four taxpayers.43

The American Bar Endowment decision illustrates the conjunctive

36. Id. at 1581. The Federal Circuit relied to a great extent on Singer Co. v. United States, 449 F.2d 413 (Ct. Cl. 1971),reh'g denied, 197 Ct. Cl. 1091 (1972), in which the court of claims rejected the Duberstein disinterested motives test. The Supreme Court decision in American Bar Endowment overrules Singer on this point.
37. American Bar Endowment, 761 F.2d at 1582; compare with American Bar Endowment, 477 U.S. at 117. The Supreme Court, by placing the burden on the taxpayer to prove intent and excess value, is assuming that such detailed comparative analysis will be conducted by the taxpayer before making the payment to the charitable organization.
38. American Bar Endowment, 761 F.2d at 1582.
39. Id. at 1583.
41. Id.
42. Id. at 117.
43. Id. at 117-18.
nature of the two-pronged test. The taxpayers had failed to establish they could have obtained insurance for less money. Lacking such a showing, the Court assumed that the value of the ABE's insurance to these taxpayers at least equalled their premium payments. The claims court had stated that the lack of information as to less expensive insurance does not support a finding that the taxpayer acted for reasons other than his own economic interest. It was upon this rationale that the Court rested its holding that these taxpayers had failed to meet the second prong of the test, namely that they had transferred money in excess of the benefit received in return. The fourth taxpayer established the excess value prong, but failed to demonstrate that he had purposely paid more than the market value because he intended to make a contribution. The taxpayer had testified that he was aware that a portion of his premium payment would go to the ABE. The Court held that such awareness is not sufficient to establish charitable intent. The Court further noted that nothing in the record suggested that the taxpayer had bypassed the opportunity for cheaper insurance in order to make a contribution to the ABE.

The Supreme Court decision in American Bar Endowment has established the two-pronged test for determining when a payment to a qualified organization is a tax deductible contribution.

III. THE SCIENTOLOGY CASES

Before examining the Scientology cases it is helpful to make a few observations. The deductibility of a payment to a qualified organization is only brought into question when the payor receives a benefit in return, as in American Bar Endowment and the Scientology cases. This has two implications: first, there must be a benefit received; and second, it must be received in exchange for the payment. Hence, the issues which arise in the Scientology cases revolve around the existence of a benefit and an exchange.

44. Id. (the taxpayer must satisfy both elements of the standard in order to claim a charitable contribution deduction).
45. Id. at 117.
46. Id. at 118.
47. Id.
48. Id. (the court's language is strong with regard to proof on intent to make a gift. The fact that the money was in fact used for a charitable purpose is not relevant. The taxpayer must prove the intent to make a gift).
49. Id.
A. Factual Background

Scientologists believe that in every person an immortal spiritual being exists independent of body and mind. A scientologist becomes aware of this unconscious spiritual dimension through a process called auditing. Auditing sessions are conducted individually, but are not individually tailored. The sessions are ritualistic in nature. Scientologists also take training courses in which they study the doctrines, tenets, codes, policies, and practices of the Church. The government stipulated to the fact that auditing and training were the essential religious practices of Scientology.

One of the tenets of Scientology is that any time a person receives something, he must pay something back. This is called the doctrine of exchange. The Church applies this doctrine by charging a fixed donation for auditing and training. The fixed donations are generally a prerequisite to a person's participation in the practices. The Church publishes an established price list for the services. The Church encourages members to pay in advance by offering a five percent discount. The Church issues accounts to members. Payments are credited to the account and the account is debited when the member begins receiving a service. The Church has a policy to refund advance payments upon request at any time before services are received.

B. Procedural Background

Many Scientology members had claimed deductions for payments made to the Church for auditing and training sessions. The IRS initially challenged the deductibility of the payments in a 1978 revenue ruling, concluding that such payments, like tuition fees paid to private or church schools, were not deductible unless the taxpayer proved the donation exceeded the fair market value of the benefits received in return. Katherine Graham's case became the tax court's test case, with the IRS and the taxpayers, Miller and Hernandez included, agreeing to be bound by the relevant factual and legal findings.

50. Staples, 821 F.2d at 1325.
51. Id. See also Miller, 829 F.2d at 501.
52. See generally Staples, 821 F.2d at 1325; Graham, 822 F.2d at 846, 847.
53. Miller, 829 F.2d at 501 (perhaps 1,000 taxpayers have claimed deductions for payments made to the Church of Scientology for auditing and training sessions).
54. Rev. Rul. 78-189, 1978-2 C.B. 68-69 (the IRS ruled the scientologists were not entitled to a charitable deduction for any part of the fixed donation made to the Church to pay for the services unless the taxpayer could establish that the fixed donation exceeded the market value of the benefits received).
55. See id.; see also Oppewal v. Commissioner, 468 F.2d 1000 (1st Cir. 1972) (a deduction was denied for tuition paid to private or church schools in the form of donations); see also DeJong v. Commissioner, 309 F.2d 373 (9th Cir. 1962).
ings of the court in the Graham case.\textsuperscript{58}

The tax court held that Katherine Graham's payments were not deductible contributions.\textsuperscript{57} The court noted that the taxpayer had the burden of proving that the payment was a voluntary transfer without consideration.\textsuperscript{58} The tax court focused on the external features of the transaction in reaching its determination that Graham had made the payments and had received religious services and thereby received perceived benefit from the transfer.\textsuperscript{59} Graham and other taxpayers appealed to the court of appeals. Graham argued that the tax court had applied the incorrect rule of law by failing to focus on the nature of the benefits she received, i.e., religious benefits.\textsuperscript{60} Staples and Hernandez argued that, as a matter of law, the return of a religious benefit, as opposed to an economic or financial benefit, cannot result in denial of a section 170 deduction.\textsuperscript{61}

\section{C. The Graham Decision}

The Ninth Circuit did not accept Graham's contention.\textsuperscript{62} The \textit{Graham} court began its opinion by stating "the rule in this circuit is that a charitable gift or contribution must be a payment made for detached and disinterested motives."\textsuperscript{63} The court felt this was the proper test for ensuring that no measurable, specific return comes to the payor as a \textit{quid pro quo} for the donation. The court found this test to be in full accord with the Supreme Court's opinion in \textit{American Bar Endowment} and also found support in the congressional record.\textsuperscript{64}

The court went on to examine the relevance of the type of benefit received by the payor. The court concluded that the type of benefit received is not important, just whether there is a specific, measurable \textit{quid pro quo}.\textsuperscript{65} The inquiry remains whether the donation was in-

\begin{thebibliography}{9}
\bibitem{56} Miller, 829 F.2d at 501.
\bibitem{57} Graham, 83 T.C. at 581.
\bibitem{58} Id. at 580.
\bibitem{59} Id. at 580-81.
\bibitem{60} Graham, 822 F.2d at 848. Note that the taxpayer is not challenging the tax court's finding of a bargained for exchange.
\bibitem{61} Staples, 821 F.2d at 1326; Hernandez, 819 F.2d at 1216-7.
\bibitem{62} Graham, 822 F.2d at 848.
\bibitem{63} \textit{Id. See supra} note 19 and accompanying text.
\bibitem{64} Graham, 822 F.2d at 849 (citing S. Rep. No. 1622, 83rd Cong., 2d Sess. 196, \textit{reprinted in} 1954 U.S. Code Cong. & Admin. News 4629, 4831). This report presents the discussion accompanying the passage of the 1954 Internal Revenue Code. This passage is the single instance in which Congress defines the term charitable gift.
\bibitem{65} Id.
\end{thebibliography}
tended to benefit the charity without reference to a reciprocal and specific benefit to the donor, whether or not the benefit is religious.\textsuperscript{68} The court reached the factual determination that Graham had made the payments with the expectation of receiving a definite number of hours of auditing in return.\textsuperscript{67} The court also concluded that the auditing sessions had measurable attributes. The court focused on the external features of the transaction in reaching these conclusions. The set price lists, the contractual right to receive the sessions or a right to a refund, account cards and discounts for advance payments all underscored that the transaction was structured in the form of a \textit{quid pro quo} and that the benefits had a measurable value.\textsuperscript{68} The last task for the court was to determine the value of the religious benefits. The court’s only statement as to valuation was that it “was easy for the tax court to determine . . . [value] simply by looking at the amount of money they were willing to pay for it in a market setting.”\textsuperscript{69}

\textbf{D. The Staples Decision}

Maureen Staples urged the Court of Appeals for the Eighth Circuit to accept her contention that the tax system does not treat religious services as commodities that are purchased and therefore she did not receive a recognizable return benefit for her charitable payments.\textsuperscript{70} The court agreed with her and allowed her to deduct her payments as contributions.\textsuperscript{71}

The court began its analysis by stating that a construction of section 170 “sensitive to religious practices would be consistent with the policies underlying the statutory provision.”\textsuperscript{72} Further, “[i]n the case of a contribution to a charitable organization, the law’s policy finds charity in the purpose and works of the qualifying organization, not the subjective intent of the contributor.”\textsuperscript{73} The \textit{Staples} court cited a 1971 revenue ruling in support of the proposition that religious observance of any faith is considered to be of benefit to the general public as well as to the members of the faith, “with private benefit

\begin{itemize}
  \item \textsuperscript{66} Id.
  \item \textsuperscript{67} Id. at 850.
  \item \textsuperscript{68} Id.
  \item \textsuperscript{69} Id.
  \item \textsuperscript{70} \textit{Staples}, 821 F.2d at 1327; see also Rev. Rul. 67-246, 1967-2 C.B. 104, 105 (stating that if the payment is in the form of a purchase of an item of value then the presumption arises that no gift has been made). The \textit{Staples} court concluded that no such presumption arises when the item purchased was the right to participate in religious practices. \textit{Staples}, 821 F.2d at 1327.
  \item \textsuperscript{71} Id. at 1326 (construing Helvering v. Bliss, 293 U.S. 144, 151 (1934)).
  \item \textsuperscript{72} Id. (citing Crosby Valve and Gage Co. v. Commissioner, 380 F.2d 146, 147 (1st Cir. 1967)), \textit{cert. denied}, 389 U.S. 976 (1967).
\end{itemize}

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being merely incidental to the broader good that is served.”

With these observations in mind, the court cited *Haack v. United States*, a 1978 opinion, stating that “Congress recognized that when a contributor would receive a material *quid pro quo*, the amount of the donation . . . would be reduced by the cost of providing the tangible benefit.” The adjectives “material” and “tangible” replaced the adjectives “specific” and “measurable” which were used by the *Graham* court. The final step for the court was to cite *Murphy v. Commissioner*, a tax court decision, in support of the proposition that spiritual gain to a member cannot be valued by any measure known in the secular realm and as such, privileges arising from church membership are not significant return benefits within the meaning of section 170. It was upon these authorities that the court based its holding that regardless of the circumstances surrounding the payment, “an amount remitted to a . . . church with no return other than participation in strictly religious practices is a contribution within the meaning of section 170.”

After stating its holding, the court went on to state that “because of the inherently charitable nature of religious practices and because of the incongruity of attempting to place a market value on religious participation” it was hesitant to agree with the First Circuit that the payments are not contributions. Moreover, the court stated the absence of a tangible return benefit with a measurable secular value makes the analysis of *American Bar Endowment* inapplicable by its very nature to the *Staples* situation.

**E. The Hernandez Decision**

Scientologist Robert Hernandez asked the Court of Appeals for the First Circuit to conclude that, as a matter of law, the return of a commensurate religious benefit, as opposed to a financial or economic benefit, cannot result in the denial of a section 170 deduction. The court first noted that Hernandez’ claim, that all payments to churches for religious services, whether gifts or not, should be deductible under section 170, was contrary to the plain language

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76. Id. (citing *Murphy v. Commissioner*, 54 T.C. 249, 253 (1970)).  
77. Id.  
78. Id.  
79. Id. at 1328.  
80. *Hernandez*, 819 F.2d at 1216-17.
and legislative history of section 170. 81 “Section 170 explicitly provides that payments to churches and other qualifying organizations are deductible only if they are ‘contribution[s] or gift[s].’” 82 The court stated that it could find no indication that Congress intended to distinguish religious benefits from medical, scientific, educational, literary, or other benefits which could likewise provide consideration for a nondeductible payment to a charitable organization. 83

Having decided that the nature of the benefits, religious or not, was not relevant for section 170 purposes, the court moved on to consider valuation issues. Hernandez claimed it was impossible for the government to determine the economic value of religious benefits. 84 The court noted that the government had assigned economic value to secular benefits such as adoption services, symphony performances and museum admission, even though those services are, in theory, difficult to monetize. 85 The court stated that in these cases courts do not look to the intrinsic value of the benefits, but instead either to “(1) the price set by the service providers, (2) the prices set by providers of similar services, or (3) the costs of providing the service.” 86

Having concluded that religious benefits could provide the quid pro quo of a nondeductible payment and that a monetary value could be placed on religious benefits, the court applied the two-pronged test of American Bar Endowment. 87 The court noted that Hernandez had not alleged that his intentions were any different from Katherine Graham’s, nor did Hernandez claim he had contributed money in excess of the benefit he received in return. The court had little difficulty in holding that Hernandez had failed to shoulder the burden of proof assigned him by the Supreme Court. 88

IV. ANALYSIS

A. Preference For Religious Organizations or Practices

As Graham and Staples are essentially different interpretations of section 170, a logical place to begin an analysis is with the courts’
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treatment of the statute. Section 170 in its simplest form authorizes a deduction for contributions to religious, charitable, scientific, literary and educational purposes. The Graham court noted that the statute cannot be read to favor religious over non-religious organizations and, therefore, the deductibility of a payment does not depend on whether the benefits received in return are secular or religious.89 Staples, on the other hand, stated that a construction of section 170 "sensitive to religious practices would be consistent with the policies underlying the statutory provision."90 The Staples court did not expressly state whether it would extend this same sensitive construction to non-religious benefits, such as symphony performances. However, the implication is certainly that religious practices merit some special treatment. The court cited a 1934 Supreme Court case, Helvering v. Bliss,91 as support for this sensitive construction.92 However, in Bliss, the Supreme Court was addressing the mechanics of how a taxpayer should take charitable contributions into account when determining taxable income.93 The court was not addressing substantive issues under the charitable contribution statute.94 Hence, the religious or non-religious nature of the organization was irrelevant to the holding in Bliss.96 The Bliss decision supports a broad construction of the charitable contribution deduction, but certainly does not support favoring religious over non-religious organizations or donors.

The Staples decision also cited Crosby Valve & Gage v. Commissioner,98 a 1967 decision out of the Court of Appeals for the First Circuit, stating that "the law's policy finds charity in the purposes and works of the qualifying organization and not in the subjective intent of the contributor."99 Notwithstanding the fact that the cited passage is dictum,88 the passage does not support a construction of

89. Graham, 822 F.2d at 849.
90. Staples, 821 F.2d at 1326.
92. Staples, 821 F.2d at 1326.
93. Helvering, 293 U.S. at 145 ("These cases present the question whether deductions on account of charitable contributions are to be taken from net income . . . or from ordinary net income.").
94. See id. at 146. (The taxpayer, Bliss, had made charitable contributions totaling $44,000. There was no dispute as to whether the amount paid qualified as a charitable deduction.).
95. See id. The Bliss decision does not even identify the religious or non-religious nature of the charitable organization involved.
96. 380 F.2d 146 (1st Cir.), cert. denied, 389 U.S. 976 (1967).
97. Crosby Valve & Gage, 380 F.2d at 147.
98. Id. The court affirmed on the alternate ground that there was no reason for a difference in tax treatment merely because the income was earned by a wholly owned...
section 170 favoring religious organizations. Further, the authority is clearly overruled by the Supreme Court decision in *American Bar Endowment*. The *Graham* and *Hernandez* decisions relied on a simple reading of the code. Section 170 draws no distinction among the various types of organizations. The statute simply lists the types of organizations in a simple series, communicating no governmental preference for any particular organization. The fact that the benefits received by the taxpayer are religious should not bear on the determination of deductibility of the payments.

**B. Relevance of The Type of Benefit Received**

As previously stated, the issue of deductibility arises whenever the taxpayer receives a benefit in return for a payment. The *Staples* court concluded that because the right to participate in religious practices could not be valued in monetary terms and because the benefit was not material or tangible, it was therefore not a recognizable return benefit. The *Graham* court, on the other hand, had no difficulty in concluding that the religious practices were a specific, measurable return, and therefore adequate to preclude a deduction. The *Staples* court found support for its decision because the benefits received by the scientologists were (1) religious, (2) intangible, and (3) not capable of being valued in monetary terms.

The Scientology cases are certainly not the first time the courts have addressed the issue of deductibility of payments for religious benefits. However, because all of the prior cases arose before *American Bar Endowment*, the central issue was how the courts should determine whether the payment was a gift. The courts did not attempt to identify and separate the religious and secular aspects of the return benefits.

In *Staples*, the taxpayers were not contending the fact that there was an exchange or the fact that they received benefits, rather, they were contending that religious benefits are not recognizable. The *Staples* court cited the 1970 tax court decision, *Murphy v. Commissioner*, for support that religious practices are not recognizable. However, the issue in *Murphy* was the deductibility of payments made to a nonprofit, secular, adoption agency. The *Murphy* court subsidiary rather than directly by the tax exempt organization.

100. *Graham*, 822 F.2d at 849.
102. *See generally Hobbet*, supra note 18.
103. *See generally Hernandez*, 819 F.2d at 1217.
104. *Staples*, 821 F.2d at 1326.
105. 54 T.C. 249 (1970).
106. *Staples*, 821 F.2d at 1326.
used religious practices as an example of a type of benefit which can inure to the general public and only incidentally to the taxpayer making the payment. It is generally accepted that indirect, or incidental benefits are not recognizable.  

The Murphy court focused upon the indirect nature, not the religious nature of the benefits. As such, Murphy does not support the broad proposition that all religious practices are nonrecognizable, rather that all indirect benefits are nonrecognizable.  

The facts in the scientology cases do not support the conclusion that the auditing sessions are an indirect benefit. The very structure of the transaction serves to insure that the benefit of the auditing session inured primarily to the one who pays the fixed fee. The Church's literature emphasizes that the benefit of auditing is personal. Contrary to Staples, the weight of authority does not support that the religious nature of the benefits is relevant to recognizability. The facts do not support that the benefits of auditing inure primarily to the general public and only indirectly to the paying members.

The legislative record of section 170 sheds no light on the issue of the type of return benefits. However, there is a passage in the record pertaining to section 163 entitled Trade or Business Expense, which has been cited by American Bar Endowment, Graham and Staples. This passage defines a charitable contribution as a payment "made with no expectation of a financial return commensurate with the amount of the [contribution]." The Staples court essentially interpreted this statement as meaning that the sole type of return benefit which Congress intended to exclude was a financial benefit. The Staples court pointed out that the cases dealing with non-deductible payments "generally have referred to a material, financial, or economic benefit being received in return." The Graham court

108. Id. at 253 (indirect benefits "are not significant return benefits that have a monetary value within the meaning of section 170.").
109. Id.
110. See Miller, 829 F.2d at 505.
111. Id.
112. See id. at 504 ("neither statute nor case law embody any fundamental distinction between 'religious' and 'economic' benefits").
113. S. REP. NO. 1622, supra note 64, at 4017, 4050, 4660, 4843. The legislative review does not discuss the definition of the term contribution, rather the discussion centers on the technical, mechanical aspects of calculating the deduction.
114. Id. at 4831.
115. Id.
116. See Staples, 821 F.2d at 1326.
117. Id.
concluded that the test is not the economic character of what the payor receives, but whether there is a specific and measurable *quid pro quo* for the donation.\textsuperscript{118} Did Congress or the Supreme Court intend to provide a blanket exclusion for all intangible and noneconomic benefits?

The legislative history does define the *quid pro quo* in terms of a financial return.\textsuperscript{119} However, one sentence later, the Senate Report says the contribution deduction applies “only if there [is] no expectation of any *quid pro quo*.”\textsuperscript{120} In this sentence the adjective is “any.” Similarly, the Supreme Court said “any” *quid pro quo* in its *American Bar Endowment* decision. “The taxpayer . . . must . . . demonstrate that he [or she] purposely contributed money . . . in excess of the value of any benefit received in return.”\textsuperscript{121} Admittedly, the benefits received by the taxpayer in *American Bar Endowment* were financial, but the Supreme Court cited two prior decisions in which the lower courts disallowed payments because the taxpayer received intangible services in return.\textsuperscript{122} In 1968 the IRS ruled that an annual membership in an art museum was a return benefit sufficient to bar a deduction.\textsuperscript{123} The charitable purpose of the art society was to develop the study of art. The benefits received by the members were participation in art events, showings, and lectures. As the code states no preference for religious practices, it is difficult to see how the benefits of the scientologists differ from those of the art museum members. The *Staples* conclusion that religious benefits are, as a matter of law, not recognizable under section 170\textsuperscript{124} seems unsupported by the clear, plain language of the legislative history, the Supreme Court precedent, and the IRS ruling.

### C. Relevance of Valuation

The *Staples* court concluded that the right to participate in religious practices “cannot be valued by measure known in the secular realm.”\textsuperscript{125} The court stated that, “[w]e are hesitant to accept [that participation in religious practices is adequate consideration] both because of the inherently charitable nature of strictly religious practices and because of the incongruity of attempting to place a market

\textsuperscript{118} Graham, 822 F.2d at 849.

\textsuperscript{119} S. Rep. No. 1622, \textit{supra} note 64, at 4831.

\textsuperscript{120} Id.

\textsuperscript{121} \textit{American Bar Endowment}, 477 U.S. at 118.

\textsuperscript{122} Id. (citing \textit{Murphy}, 54 T.C. at 254 and \textit{Oppewal}, 468 F.2d at 1002).

\textsuperscript{123} Rev. Rul. 68-432, 1968-2 C.B. 104, 105 (the membership payments had a reasonable relationship to the monetary value of the corresponding benefits of membership).

\textsuperscript{124} \textit{Staples}, 821 F.2d at 1328.

\textsuperscript{125} Id. at 1327.
value on religious participation." Bear in mind that the Supreme Court held that value is a factual determination for the court with the burden of proof on the taxpayer. How the Staples court can justify elevating the valuation issue to a legal significance is not clear.

Both the Graham and Hernandez courts properly treated the valuation issue as one of fact. The Hernandez court cited authority for various valuation alternatives available to courts in different situations. In such cases the courts and the IRS look not to the intrinsic value of the benefits, but instead either to (1) the price set by the providers, (2) the price set by providers of similar services, or (3) the costs of providing the services.

Finally, the fact that the Church is able to place a fixed value on the services undermines the Staples conclusion that it is improper to place a value on such religious practices. Even if one assumes that the taxpayer could successfully carry the burden of proving the religious benefits have no economic value, the logical conclusion is that only one prong of the American Bar Endowment test would have been met, i.e., the excess value prong. The taxpayer would still have to convince the court that the excess payment was made with the intention of making a gift rather than the intention of receiving services.

D. Relevance of Transactional Form

In Graham, the tax court found that the Church was operating in a commercial manner by providing the auditing and training courses. The payments to the Church had all of the characteristics of a payment for retail goods. The Church even called the donation an exchange. The substance of a contribution is the lack of an exchange. Yet the Staples court looked not at the obvious exchange but rather at the religious nature of the Scientology activities and

126. Id. (though the statement appears to be dicta).
127. See Graham, 822 F.2d at 849; Babilonia v. Commissioner, 681 F.2d 678, 679 (9th Cir. 1982).
128. Graham, 822 F.2d at 849. In Hernandez, the court found Hernandez had failed to carry the burden of the American Bar Endowment test based on the factual findings of the record. Hernandez, 819 F.2d at 1218.
129. Hernandez, 819 F.2d at 1218.
130. Id. at 1217. See also Graham, 83 T.C. at 578. "The Church of Scientology operates in a commercial manner in providing these religious services. In fact, one of its [the Church's] articulated goals is to make money." Graham, 83 T.C. at 578.
131. Graham, 83 T.C. at 578.
the benefits received.\textsuperscript{132} The Staples court stated that Graham amounts to a holding that "the deductibility under section 170 of payments relative to participation in bona fide religious practices will depend on the mechanism adopted by the church to solicit support from its members."\textsuperscript{133} Although this statement is not true in a legal sense, it certainly has bearing in assessing the circumstances of the case. The American Bar Endowment analysis and holding make the circumstances attending the payment very relevant to determining both the intentions of the payor and the existence of excess value.\textsuperscript{134} The arguments in Staples fail to recognize that even payments to a church for religious services can be structured, as here, so that the religious services are a \textit{quid pro quo} for the payment.

\textbf{V. Conclusion}

Through section 170 of the Internal Revenue Code Congress, has provided taxpayers with the means to support charitable organizations with tax deductible gifts. Congress said, and meant gifts, not payments. The Supreme Court supplemented the code by defining exactly what a taxpayer must demonstrate in order to claim a charitable deduction. The American Bar Endowment test is true to the intent of section 170 in that it allows a deduction for gifts and excludes a deduction for payments. Admittedly, the factual determination of the payor's subjective intentions and the objective determination of value can be difficult, but that is the task assigned by the Supreme Court. The Staples court chose to ignore an obvious exchange situation and instead looked to the ecclesiastical nature of the return benefit. Clearly, the scientologists were not making gifts to the Church, yet the Staples court held that the scientologists satisfied the requirements for a section 170 deduction. The Graham and Hernandez decisions properly recognized that the religious nature of return benefits is not relevant to the determination of deductibility under section 170. The split in authority created by the Graham and Staples decisions should be eliminated by codification of the American Bar Endowment two-pronged test.

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\textsuperscript{132} Staples, 821 F.2d at 1326.
\textsuperscript{133} Id.
\textsuperscript{134} American Bar Endowment, 477 U.S. at 117.