FILED
DEC 26 2006
CATHY A. CATTERSON, CLERK
U.S. COURT OF APPEALS

No. 06-72961

IN THE UNITED STATES COURT OF APPEALS
FOR THE NINTH CIRCUIT

MICHAEL SKLAR
and MARLA SKLAR,

Appellants,

v.

COMMISSIONER OF INTERNAL REVENUE,

Appellee.

On Appeal from the United States Tax Court

REPLY BRIEF FOR APPELLANTS

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December 18, 2006

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Appellants Michael and Marla Sklar (hereinafter "the Sklars") respectfully submit this reply to the Brief for the Appellee.

SUMMARY OF REPLY ARGUMENT

The Government has not responded to some of our key arguments; has misstated others before responding to them; and has even attempted to rewrite Rev. Rul. 70-47, 1970-1 C.B. 49, in order to defend IRS' position here. Perhaps most tellingly, but understandably, the Government all but concedes that IRS is violating the First Amendment by permitting practitioners of one religion, Scientologists, to deduct as charitable contributions their payments for religious instruction, but disallowing such deductions by practitioners of other religions. The Government, however, seeks to immunize IRS' contempt for the Constitution from judicial review.

We make two fundamental arguments on this appeal. Our first contention is that the Sklars' payments to their children's schools in 1995 for their children's religious education were deductible as charitable contributions under I.R.C. §170, because they were payments to religious organizations in exchange for which the Sklars received only intangible religious benefits.

In opposition to this contention, the Government makes essentially five arguments:

1. The Government argues that the Supreme Court ruled in Hernandez v. Commissioner, 490 U.S. 680 (1989)("*Hernandez*"), that payments in exchange for intangible religious benefits, including payments for religious education, are just like all other *quid pro quo* payments, and therefore are not deductible as charitable contributions; and nothing in the 1993 amendments to the Internal Revenue Code changed this. We submit, however, that the 1993 amendments overruled *Hernandez* to the extent of making it clear that payments in exchange for intangible religious benefits, to entities organized exclusively for religious purposes, are deductible as charitable contributions. Indeed, IRS itself recognized this immediately after the 1993 amendments by permitting Scientologists to deduct their payments for "auditing" and "training" as charitable contributions, notwithstanding that these were the very types of payments disallowed in *Hernandez*.

2. The Government argues that the Sklars did not intend to make a gift when they paid for their children's religious education. Therefore, none of those payments is deductible. The crux of this case, however, is whether

payments to religious organizations in exchange for intangible religious benefits are inherently gifts or contributions for purposes of I.R.C. §170. Long-standing IRS practice establishes that payments to religious organizations in exchange for intangible religious benefits are deductible as charitable contributions without proof of specific intent to give a gift.

3. The Government argues that the Sklars also are not entitled to any partial deduction under a dual-payment analysis because the tuition they paid was less than they would have paid at other private schools in the area for a secular education. This argument assumes, however, that every secular education is equal -- an assumption which flies in the face of both the record below and common sense. The Sklars proved in the Tax Court that their payments to their children's schools far exceeded the tuition they would have paid at other private schools in the area for a comparable secular education.

4. The Government argues that even if the 1993 amendments overruled *Hernandez*, the Sklars' payments for their children's religious education were not deductible because the recipients were not organized exclusively for religious purposes. The Government's own description of the schools attended by the Sklars' children demonstrates,

however, that they were organized exclusively for religious purposes.

5. In any event, the Government argues, the Sklars were not entitled to deduct any of the disallowed deductions because they did not satisfy the contemporaneous substantiation requirements of I.R.C. §170(f)(8). However, over $1,400 of the disallowed deductions did not require substantiation, because they were payments of less than $250 each. Treas. Reg. §1.170A-13(f)(1). As for the rest, the Sklars' "substantial compliance" with I.R.C. §170(f)(8) is sufficient. Taylor v. Commissioner, 67 T.C. 1071 (1977).

Accordingly, this Court should reverse the Tax Court and hold that the disallowed deductions were legitimate.

Our second contention is that IRS violated the First Amendment by permitting Scientologists to deduct as charitable contributions their payments for religious education, but disallowing such contributions by practitioners of other religions, such as the Sklars (who practice Judaism). The Government does not even try to argue that this favoring of Scientologists over practitioners of other religions is lawful. It argues instead that the Sklars cannot claim the same benefit as Scientologists receive, but rather should sue IRS to stop it from giving the benefit to Scientologists.

The Supreme Court long ago held that "it is well settled that a taxpayer who has been subjected to discriminatory taxation through the favoring of others in violation of federal law cannot be required himself to assume the burden of seeking an increase of the taxes which the others should have paid." Iowa-Des Moines National Bank v. Bennett, 284 U.S. 239, 247 (1931). Moreover, third party suits "to prevent Service leniency toward other taxpayers . . . are almost always dismissed for lack of standing." Lawrence Zelenak, Should Courts Require the Internal Revenue Service to be Consistent?, 38 Tax L. Rev. 411, 429 (1985). Indeed, in arguing here that the Sklars should sue IRS to stop its leniency toward Scientologists, the Government had an ethical obligation at least to note that this Court has previously affirmed dismissal of such a lawsuit for lack of standing. Henson v. Internal Revenue Service, 2000 U.S. App. Lexis 23997 (Sept. 11, 2000).[1]

The Sklars' disallowed deductions should be allowed because of IRS' First Amendment violation, even if Scientologists are not entitled to deduct their payments for religious instruction.

The Government also asserts that, "The deductions allegedly allowed for the Church of Scientology were for 'auditing' and 'training,' activities pertaining to spiritual guidance of

[1] In accordance with Circuit Rule 36-3(c), we have attached to this brief a copy of the unpublished decision in Henson v. Internal Revenue Service, supra, as an appendix.

adults", and argues that this makes them "quite distinct from the education of school children that is at issue here." Govt Br. at 69.[2] There is no jurisprudential distinction between payments for religious instruction for adults and payments for religious instruction for children. Moreover, the Government knows very well that children, too, receive "auditing" and "training" in the Church of Scientology, and IRS permits their parents to deduct payments for this religious instruction as charitable contributions. This is not in the trial record, however, because the Tax Court sustained the Government's and the Church of Scientology's objections to our attempts to conduct discovery, and to present at trial testimony and other evidence concerning these matters.

If this Court is not satisfied that auditing, training and other qualified religious services in the Church of Scientology are similar to the religious studies of the Sklar children, or that IRS permits payments for those services to be deducted as charitable contributions, it should remand this case to the Tax Court for further trial and findings on these issues.

[2] As used in this Reply Brief, "Initial Br." refers to the Brief for Appellants; "Govt Br." refers to the Brief for the Appellee; and "R." refers to the Excerpts of Record which Appellants filed.

ARGUMENT

I. THE TAX COURT DECISION SHOULD BE REVERSED BECAUSE THE SKLARS' PAYMENTS TO THEIR CHILDREN'S SCHOOLS FOR THEIR CHILDREN'S RELIGIOUS STUDIES WERE PAYMENTS TO ORGANIZATIONS ORGANIZED SOLELY FOR RELIGIOUS PURPOSES, IN EXCHANGE FOR WHICH THE SKLARS RECEIVED ONLY INTANGIBLE RELIGIOUS BENEFITS, AND THEREFORE WERE DEDUCTIBLE AS CHARITABLE CONTRIBUTIONS UNDER I.R.C. § 170.

We explained in our initial brief that:

- as amended in 1993, I.R.C. §170 permits taxpayers to deduct as charitable contributions payments to entities organized exclusively for religious purposes even if they receive intangible religious benefits in return;

- the schools that the Sklars' children attended in 1995 were organized exclusively for religious purposes;

- the Sklars paid $175 to one of the schools for an extracurricular, after-school Mishna class, in exchange for which they received solely an intangible religious benefit (i.e., their son's study of Mishna);

- the Sklars paid another $27,108 to the two schools, for their children's religious education (which provided only intangible religious benefits) and secular education (which provided both religious and secular benefits);

- the value of the children's secular education was no more than $7,484.50; and

- thus, in 1995, the Sklars paid the two schools at least $19,798.50 for their children's religious education (including their son's Mishna classes), in exchange for which they received only intangible religious benefits.

Thus, the Sklars were entitled to deduct $19,978.50 of their payments to the schools as charitable contributions. In fact, they deducted, and IRS disallowed, only $15,000.00. Therefore, the full amount they deducted should have been allowed.

The Government, of course, disputes this, but its arguments are not consistent with the law or the facts.

A. *Hernandez* is not controlling, because key aspects of that decision were overruled by 1993 amendments to the Internal Revenue Code.

As we explained previously, Initial Br. at 28-30, it is well-established that payments to churches, synagogues and other religious organizations may constitute a "contribution or gift" for purposes of §170 even if the taxpayer receives consideration, provided that the consideration is intangible religious benefits.

The Government insists, however, that under *Hernandez*, "where a taxpayer receives religious benefits in exchange for his payments, the taxpayer is receiving consideration in exchange for his payments, and no charitable deduction is available", Govt Br. at 35, and that none of the 1993 amendments

to the Internal Revenue Code affected in any way this 1989 ruling. The Government is wrong.

The Government argues that, "Congress's 1993 amendments to the Tax Code did not . . . legislatively overrule *Hernandez* and permit a charitable deduction for any part of a payment allocable to an intangible religious benefit." Govt Br. at 41. However, while the Government refers to I.R.C. §6115, which was enacted post-*Hernandez*, in 1993, Govt Br. at 43, it ignores the plain language of that provision:

> A quid pro quo contribution does not include any payment made to an organization, organized exclusively for religious purposes, in return for which the taxpayer receives solely an intangible religious benefit that generally is not sold in a commercial transaction outside the donative context.

This directly contradicts, and thus overrules, the Supreme Court's earlier ruling in *Hernandez*.

Moreover, IRS itself recognized that the 1993 amendments to I.R.C. §§170(f)(8) and 6115 overruled *Hernandez* when it issued Rev. Rul. 93-73, 1993-2 C.B. 75. Fifteen years earlier, in Rev. Rul. 78-189, 1978-1 C.B. 68, IRS declared that payments by Scientologists for "auditing" and "training" were not deductible. After the 1993 amendments, Rev. Rul. 93-73 "obsoleted" Rev. Rul. 78-189. The Government argues:

> The inference taxpayers would draw from the obsoleting of Rev. Rul. 78-189, that the IRS was rejecting *Hernandez*, cannot properly be made. A revenue ruling can be obsoleted for a variety of reasons and there is

> nothing in the record to establish that Rev. Rul. 78-189 was obsoleted for the reasons taxpayers suggest.

Govt Br. at 49 n.8. There is nothing in the record as to why Rev. Rul. 78-189 was obsoleted because the Tax Court sustained IRS' objections to the Sklars' discovery requests concerning this. The Government's argument here is reminiscent of Lizzie Borden's plea for mercy because she was an orphan. IRS knows why it obsoleted Rev. Rul. 78-189, and presumably would state the reason if it were something other than IRS' recognition that the 1993 amendments overruled *Hernandez*. Indeed, the burden is on IRS to prove that Rev. Rul. 78-189 was obsoleted for another reason. I.R.C. §7491(a)(1).

Not only is the statutory language clear on its face, but the Government quotes one previously uncited part of the legislative history of the 1993 amendments which further confirms that Congress intended to overrule *Hernandez*:[3] "no inference is intended, however, regarding the full or partial deductibility of any payment outside the scope of the *quid pro quo* disclosure provision or substantiation provision under the

[3] The Government also cites and quotes a Senate Budget Committee Print which says that "tuition for education leading to a recognized degree" is not a payment in exchange for an intangible religious benefit. Govt Br. at 47. The same statement appears in the Conference Report on the 1993 amendments. See Initial Br. at 34. As we explained previously, id., this further confirms that the Sklars' payments for their children's religious education are deductible, because that religious education was not leading to a recognized degree.

present-law requirements of section 170." H.R. Conf. Rep. No. 103-213, at 567 (1993), *reprinted in* 1993 U.S.C.C.A.N. 1088, 1255, quoted in Govt Br. at 48-49. This shows that Congress intended to change the deductibility of payments within "the scope of the *quid pro quo* disclosure provision or substantiation provision", i.e., payments to religious organizations in exchange for intangible religious benefits: *Hernandez* had called into question the deductibility of all such payments, and Congress was now making clear that they are deductible.

The Government has another problem in trying to argue that *Hernandez* does not permit deduction of payments in exchange for intangible religious benefits: IRS in fact generally permits such deductions. The Government tries to reconcile its argument here with IRS' general practice by attempting to rewrite one of IRS' Revenue Rulings:

> [T]he IRS has ruled that a benefit bestowed in return for a contribution can be incidental or *de minimis* so as not to affect the charitable nature of the entire payment. . . . [I]n the religious context, the IRS ruled that "pew rents" or admission tickets to obtain special seating at a religious service really are charitable donations that carry with them an incidental benefit, because the religious service is open to the general public and the donor could attend it without the donation. *See* Rev. Rul. 70-47, 1970-1 C.B. 49.

Govt Br. at 40. The Government is attempting here to rewrite Rev. Rul. 70-47.

Rev. Rul. 70-47 states, in full:

> Pew rents, building fund assessments, and periodic dues are methods of making contributions to a church and are deductible as charitable contributions; A.R.M. 2 superseded.
>
> Pew rents, building fund assessments, and periodic dues paid to a church (an organization described in section 170(c) of the Internal Revenue Code of 1954) are all methods of making contributions to the church, and such payments are deductible as charitable contributions within the limitations set out in section 170 of the Code.
>
> A.R.M. 2, C.B. 1, 150 (1919), is hereby superseded since the position set forth therein is updated and restated under the current statute and regulations in this Revenue ruling.

Contrary to what the Government asserts in its brief here, nothing in this Revenue Ruling says that a pew rent, building assessment or periodic dues payment is deductible only if the benefit received in return is *de minimis;* nothing in this Revenue Ruling says that the benefit received in exchange for a pew rent, building assessment or periodic dues is "incidental"; and nothing in this Revenue Ruling says that a pew rent, building assessment or periodic dues payment is deductible only if the religious service is open to the general public. *Pace* the Government, a pew rent, building assessment or periodic dues payment is deductible regardless of the value of the benefit received in return, and regardless of whether the church's religious services are open to the general public.

In short, the 1993 amendments reversed *Hernandez* to the extent of making it clear that payments to entities organized exclusively for religious purposes are deductible as charitable contributions, even if the taxpayer receives intangible religious benefits in exchange for the payments.

B. It is not necessary for a taxpayer to have specific intent to make a gift in order to deduct a payment in exchange for intangible religious benefits as a charitable deduction.

The Government argues at length that none of the Sklars' disallowed payments to their children's schools were deductible as charitable contributions because the Sklars did not intend to make a gift or contribution to the schools. However, a pew rent, building assessment or periodic dues payment is deductible regardless of whether the taxpayer intends to make a gift to the church; a pew rent, for example, is deductible even if all the taxpayer wants is to be able to sit in a particular pew, and has no interest whatsoever in making a gift to the church.

In this context, the Government misstates the holding in United States v. American Bar Endowment, 477 U.S. 105 (1986). The Government asserts that, "under *American Bar Endowment*, part of a payment can be deducted under a dual-payment analysis only where the size of the payment is 'clearly out of proportion to the benefit received' and the payment was made with the intention of making a gift. *American Bar Endowment*, 477 U.S.

at 117." Govt Br. at 50. *American Bar Endowment* does not, however, require that the payment was made with specific intention of making a gift. Rather, the Supreme Court held that the taxpayers in *American Bar Endowment* could have deducted part of their insurance payments if (i) they could have purchased similar policies at a lower cost, and (ii) they had known that they could have purchased similar policies at a lower cost. Id. at 118. If these two conditions are satisfied, the excess payment is deemed a gift, without proof of specific intent to make a gift.

Here, assuming as the Government argues that dual payment analysis is appropriate, the Sklar children's secular education is the equivalent of the insurance policies in *American Bar Endowment*. Therefore, the Sklars were entitled to deduct part of their payments to their children's schools if (i) they could have purchased comparable secular education for their children at a lower cost, i.e., for less than $27,108, and (ii) they knew that they could have done so. The Sklars could have done so, and they knew this, but they chose not to do so. Therefore, under *American Bar Endowment*, the Sklars were entitled to deduct as a charitable contribution the amount by which their payments exceeded the market value of a comparable secular education,

i.e., $19,798.50.[4] Per *American Endowment*, under these conditions, the excess payments are deemed a gift to the schools without proof of intent to make a gift.

According to the IRS' usual interpretation of the Code (as opposed to their interpretation solely for purposes of the case at Bar), payments to religious organizations in exchange for intangible religious benefits are deductible as charitable contributions regardless of whether the taxpayer specifically intended to make a gift to the religious organization. Such payments are deemed to be inherently "a contribution or gift" for purposes of I.R.C. §170(c). Therefore, the fact that the Sklars did not specifically intend their payments for their children's religious instruction to be gifts does not make those payments non-deductible, because the Sklars received only intangible religious benefits in exchange for those payments and thus those payments were inherently contributions or gifts.

C. The Sklars' payments to their children's schools far exceeded the price of similar secular education at other private schools in the area.

The Government argues:

> Under *American Bar Endowment*, 477 U.S. 117-18, the test for whether taxpayers paid more than the market value of the benefit received is whether they paid more than the cost at which a similar benefit could be obtained elsewhere. The allocation of time spent on

[4] The Sklars were entitled to deduct the $175 they paid for their son's Mishna class without resort to any dual-payment analysis under *American Bar Endowment*.

> secular education versus religious pursuits on which taxpayers based the amount they deducted is irrelevant to this analysis. *See Sklar I*, 282 F.3d at 621. Because, as noted above, the record established that the tuition taxpayers paid was less than they would have paid at other private schools in the area for a secular education, taxpayers cannot show they could have purchased a comparable education for less.

Govt Br. at 55-56 (footnote omitted). The first sentence is correct. The next two sentences, however, are contrary to *American Bar Endowment*, and contrary to this Court's opinion in Sklar v. Commissioner, 282 F.3d 610 (9th Cir. 2002)("*Sklar I*"). The test in *American Bar Endowment* was whether the taxpayers "could have purchased **similar** policies for a lower cost", 477 U.S. at 118 (emphasis added); and in *Sklar I*, this Court ruled that the Sklars would have to show "that any dual tuition payments . . . exceeded the market value of the secular education their children received", i.e., "the cost of a **comparable** secular education offered by private schools." 282 F.3d at 621 (emphasis added).

Therefore, *pace* the Government, the allocation of time between religious studies and secular studies at the Sklar children's schools is relevant, because it is a factor in determining the market value of the secular education in those schools; and the fact that the Sklars could have paid even more than they did for secular education at some private schools is not relevant, because the record shows that the secular

education in those schools is vastly superior to the secular education at the Sklar children's schools.

It is necessary to compare apples to apples, not to oranges. This is exactly what the Sklars' expert witness, Dr. Solmon, did for the Tax Court; and in doing so, he showed that the market value of the Sklar children's secular education was over $19,000 less than the Sklars' total payments to those schools. Their $15,000 deduction should, therefore, have been allowed.

D. The Sklar children's schools were organized exclusively for religious purposes.

The Government argues:

> Because the schools were in the business of providing secular education meeting the requirements of California state law and had obtained accreditation from nonreligious accrediting agencies, taxpayers' contention (Br. 35) that the schools were organized exclusively for religious purposes is simply untenable on its face.

Govt Br. at 62.[5] In short, the Government, like the Tax Court, argues that neither of the two schools was organized exclusively for religious purposes simply because each provided secular studies in addition to religious instruction. This argument should be rejected.

[5] Contrary to what the Government wrote here, but as it concedes elsewhere (Govt Br. at 9), neither school was accredited in 1995. In any event, accreditation would not change the exclusively religious purpose of a school any more than providing secular studies does so.

Contrary to the Government's argument, the fact that a school provides secular studies in addition to religious instruction does not logically compel a conclusion that the school is not organized exclusively for religious purposes. The question that must be asked is why the school provides the secular studies.

> The crucial inquiry . . . is not into the nature of the activity, but into the purpose accomplished thereby. . . . "The facts in each case must be explored to ascertain the predominant or primary purpose for which the organization was formed, and also the manner of its operation."

Bethel Conservative Mennonite Church v. Commissioner, 746 F.2d 388, 391 (7th Cir. 1984)(overruling Tax Court, and holding that church was organized exclusively for religious purposes notwithstanding operation of a medical aid plan for its members), quoting Passaic Hebrew Burial Ass'n v. United States, 216 F. Supp. 500, 502 (D.N.J. 1963)(holding that Jewish mortuary operated by local synagogues providing Jewish funerals and burials, for fees, only to Jews, is organized exclusively for religious purposes). If a school provides secular studies for a religious purpose, then those studies are consistent with the school being organized exclusively for religious purposes.

The fact that that each school here satisfied the requirements of California state law is not conclusive. California law did not compel either school to provide secular

studies. Each school could have provided only religious instruction, leaving parents to satisfy California's compulsory education law elsewhere, whether through home schooling, at another private school or at a public school.

Emek and Yeshiva Rav Isacsohn each provides secular studies for religious purposes, i.e., to enable parents to satisfy California's compulsory education law in an environment consistent with Orthodox Jewish beliefs and practices. As the Government concedes, "It is important to taxpayers to pass to their children a devotion to their faith, and **they deeply believe that they should educate their children in an Orthodox Jewish environment.**" Govt Br. at 6 (emphasis added). The testimony of Rabbi Krause from Yeshiva Rav Isacsohn (R.109-138) and Rabbi Wachsman from Emek (R.152-58) confirms that each school provided secular studies so that such studies would be available to children of parents like the Sklars, who wanted their children to receive all their education in an Orthodox Jewish environment. In other words, each had a religious purpose for providing secular studies. Therefore, the fact that each school provided secular studies does not change the fact that each school was organized exclusively for religious purposes.

Moreover, as we explained in Initial Br. at 43-44, IRS itself recognizes that Emek and Yeshiva Rav Isacsohn are

organized exclusively for religious purposes by exempting them from filing annual information returns under I.R.C. § 6033(a)(2)(A)(i). The Government argues here that our proof of this -- letters from IRS which are in an Appendix to our Initial Brief -- should be disregarded because they were never admitted into evidence at trial. Govt Br. at 63-64. We could not offer them at trial because IRS improperly failed to produce them in response to our pre-trial discovery requests, and we received them only post-trial, in response to Freedom of Information Act requests. IRS' wrongful failure to make disclosure should not be held against the Sklars.

Moreover, even if these documents were not in the record below, based upon them, pursuant to Fed. R. Ev. 201, this Court could and should take judicial notice of the fact that IRS exempts Emek and Yeshiva Rav Isacsohn from filing Form 990, and thus recognizes them as religious institutions. See, e.g., Bethel Conservative Mennonite Church v. Commissioner, 746 F.2d 388 (7th Cir. 1984)(Court of Appeals reversed the Tax Court after taking judicial notice of documents and facts not before the Tax Court, and ruled that appellant was organized exclusively for religious purposes).

The Government argues that the schools' exemptions from filing Form 990 could be based on the Commissioner's discretion under I.R.C. §6033(a)(2)(B), rather than mandated by I.R.C.

§6033(a)(1). Govt Br. at 64. The burden, however, is on IRS to establish that the schools are exempt from filing through an exercise of discretion. I.R.C. §§7491(a)(1). Having failed to offer any proof of this, the Government may not now contend that this may explain the schools' filing exemptions.[6]

Thus, contrary to the Government's argument, Emek and Yeshiva Rav Isacsohn are both organized exclusively for religious purposes.

E. The Sklars' payments are sufficiently substantiated.

Finally, the Government argues that the Tax Court "should be affirmed because taxpayers have not met the I.R.C. §170(f)(8)'s substantiation requirements." Govt Br. at 59. I.R.C. §170(f)(8)(A) provides that, "No deduction shall be allowed under subsection (a) for any contribution of $250 or more unless the taxpayer substantiates the contribution by a contemporary written acknowledgment of the contribution by the donee organization . . . ." This does not preclude the deductions at issue here.

[6] The Government misleadingly observes that, "the second letter . . . states explicitly that Emek is exempt as an educational institution." Govt Br. at 64. Emek is exempt from taxation as an educational institution, but this would not exempt it from filing Form 990. It is exempt from filing Form 900 because it is organized exclusively for religious purposes. Being an education institution and being organized exclusively for religious purposes are not mutually exclusive.

First, in making this argument, the Government simply ignores the Sklars' seven payments of $25 each for their son's Mishna class at Emek. Treas. Reg. §1.170A-13(f)(1) provides, in relevant part: "Separate contributions of less than $250 are not subject to the requirements of section 170(f)(8), regardless of whether the sum of the contributions made by a taxpayer to a donee organization during a taxable year equals $250 or more." Thus, the Sklars did not need §170(f)(8)-type substantiation for any of their seven payments to Emek in 1995 for their son's Mishna classes, notwithstanding that their total contributions to Emek in 1995 exceeded $250.

Treas. Reg. §1.170A-13(f)(1) also provides, in relevant part: "Section 170(f)(8) does not apply to a payment of $250 or more if the amount contributed (as determined under §1.170A-1(h)) is less than $250." In addition to their seven payments for Mishna classes, the Sklars made another eleven payments to Emek or Torath Emeth in 1995 in which the amount claimed as a contribution, as determined under §1.170A-1(h),[7] is less than $250. See Petitioners' Proposed Findings of Fact 215-222, 224-226 (Tax Court Docket No. 162) Accordingly, these eleven payments, which totaled $1,170.75, also did not require §170(f)(8)-type substantiation.

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[7] Treas. Reg. §1.170A-1(h) concerns how to determine the deductible part of a payment that is only partially deductible.

Thus, even under the strictest possible interpretation of §170(f)(8), the Sklars were entitled to deduct $1,420.75 of their disallowed charitable contributions without any §170(f)(8)-type substantiation.

As for the balance of the Sklars' claimed but disallowed deductions, it is a long-standing rule that "substantial compliance" with substantiation requirements is sufficient when those requirements do not "relate to the substance or essence of the statute", but rather "are procedural or directory in that they . . . are given with a view to the orderly conduct of business." Taylor v. Commissioner, 67 T.C. 1071, 1078 (1977). The "essence" of §170(f) is that contributions to charitable organizations are deductible. Section 170(f)(8) is a procedural means for separating deductible contributions from non-deductible payments in certain circumstances. Accordingly, under the circumstances here, where the amount, date and purpose of each payment was stipulated, substantial compliance is sufficient; and full compliance with §170(f)(8)(B) should be deemed substantial compliance, notwithstanding lateness in complying with §170(f)(8)(C).

Finally, neither school would have provided §170(f)(8)-type substantiation acknowledging that the payments at issue here were charitable contributions, because in order to avoid running afoul of IRS, as IRS acknowledged below, "neither school

considered petitioners' tuition payments to be a charitable contribution." Opening Brief for Respondent at 48 (Tax Court Docket No. 161).

In other words, the Government is arguing that the Sklars could not claim the charitable contributions they claimed without §170(f)(8)-type substantiation from each school acknowledging that the payments were charitable contributions, but the Government acknowledges that neither school would have given such substantiation because it would have brought down upon the school the wrath of IRS. Thus, the Government's argument would immunize IRS from any possible challenge to its position concerning the deductibility under I.R.C. §170 of payments for religious education. Such manifest injustice to taxpayers should not be permitted by this Court. The Sklars should not be punished for failing to accomplish something that IRS makes impossible.

Thus, as a matter of law, the Sklars were entitled to deduct $1,420.75 of their disallowed charitable contributions without §170(f)(8)-type substantiation; and the $13,579.25 balance of their disallowed charitable deductions should not be disallowed for lack of substantiation in light of their substantial compliance with §170(f)(8), i.e., full compliance with §170(f)(8)(B) and late compliance with §170(f)(8)(C).

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II. THE TAX COURT DECISION SHOULD BE REVERSED BECAUSE IT IS UNCONSTITUTIONAL, AND VIOLATES THE REQUIREMENT OF ADMINISTRATIVE CONSISTENCY, FOR IRS TO PERMIT PRACTITIONERS OF ONE RELIGION -- SCIENTOLOGISTS -- TO DEDUCT THEIR PAYMENTS FOR RELIGIOUS INSTRUCTION AS CHARITABLE CONTRIBUTIONS, BUT TO DISALLOW SUCH DEDUCTIONS BY PRACTITIONERS OF OTHER RELIGIONS, SUCH AS THE SKLARS.

Understandably, the Government does not even attempt to defend IRS' preferential treatment of Scientologists. Instead, based upon *dicta* in this Court's opinion and the concurring opinion in *Sklar I*, the Government argues that the proper remedy is a lawsuit to stop IRS' violation of the First Amendment. Govt Br. at 68-69.

This question was not briefed in *Sklar I*. Contrary to the *dicta* there, as a matter of law, the Sklars are entitled to the same tax treatment as Scientologists, even if permitting Scientologists to deduct their payments for religious education is not permitted under the Internal Revenue Code.

In Iowa-Des Moines National Bank v. Bennett, 284 U.S. 239 (1931), the Supreme Court found that a state's administration of its tax law constituted discrimination against certain taxpayers in violation of the Equal Protection Clause. The Iowa Supreme Court had recognized that there had been systemic discrimination because other taxpayers had been underassessed, id. at 241-43, but held "that the discrimination thus effected was remediable only by correcting the wrong under the state law in favor of the

competitors and not by extending the benefits as [sic] of a similar wrong to the petitioners." Id. at 244.

The Supreme Court rejected this analysis. The Court held that petitioners had been subjected to an Equal Protection violation, and were entitled to refunds, notwithstanding the fact that they had been properly assessed under the Iowa statute:

> It may be assumed that all grounds for a claim for refund would have fallen if the state, promptly upon discovery of the discrimination, had removed it by collecting the additional taxes from the favored competitors. By such collection the petitioners' grievances would have been redressed; for these are not primarily overassessment. The right invoked is that to equal treatment; and such treatment will be attained if either their competitors' taxes are increased or their own reduced. But **it is well settled that a taxpayer who has been subjected to discriminatory taxation through the favoring of others in violation of federal law cannot be required himself to assume the burden of seeking an increase of the taxes which the others should have paid.** Nor may he be remitted to the necessity of awaiting such action by the state officials upon their own initiative.
>
> The petitioners are entitled to obtain in these suits refund of the excess of taxes exacted from them.

Id. at 247 (citations omitted; emphasis supplied). Accord, e.g., Allegheny Pittsburgh Coal Co. v. County Commission, 488 U.S. 336 (1989) (although the petitioners had been properly assessed under the statute, they were entitled to refund because of constitutional violation resulting in lower taxes paid by other, similarly situated taxpayers); Hillsborough Township

v. Crowell, 326 U.S. 620, 623-24 (1946) (state law that required property owner who was assessed at true value of land but who had been singled out for discriminatory taxation to seek increase in assessment of others would violate the Equal Protection Clause); McKesson v. Division of Alcoholic Beverages & Tobacco, 496 U.S. 18, 36 (1990) (quoting Bennett, supra, 284 U.S. at 247, for the proposition that a taxpayer victimized by differential tax treatment cannot be "remitted to the necessity of awaiting . . . action [against the favored taxpayers] by the state officials").

Thus, the Supreme Court has established that a taxpayer who has been correctly assessed under a taxing statute, but has been systematically discriminated against through underassessments of others, is entitled to a refund, and may not be required to seek elevation of others' taxes. Refunds are proper relief for constitutional violations even where the disadvantaged party has been taxed in accordance with substantive law.

Moreover, as a practical matter, denying the Sklars' deductions, and relegating them to challenging IRS' favoring of Scientologists, will immunize IRS' violation of the First Amendment. As Professor Lawrence Zelenak has pointed out, "[t]here is virtually no judicial review of a Service decision to be lenient" to other taxpayers:

> Taxpayers directly affected will not challenge the position because it is favorable to them. The Service will not, of course, challenge its own position. Third parties may sue to prevent Service leniency toward other taxpayers . . . but such suits are almost always dismissed for lack of standing.

Lawrence Zelenak, Should Courts Require the Internal Revenue Service to be Consistent?, 38 Tax L. Rev. 411, 429 (1985) (footnote omitted). Indeed, in making their argument and citing the *dicta* and concurring opinion in *Sklar I*, Government counsel had an ethical obligation to call to the Court's attention the fact that this Court has previously affirmed dismissal for lack of standing of a lawsuit challenging IRS' discrimination in favor of Scientologists. Henson v. Internal Revenue Service, 2000 U.S. App. Lexis 23997 (Sept. 11, 2000).[8] (Kenneth L. Greene, Esquire, who represents the Government here, also represented IRS in Henson.)

Thus, even if the Court concludes that the Internal Revenue Code does not permit the Sklars, Scientologists, or anyone else to deduct as charitable contributions their payments for religious instruction, the Sklars' deductions must be allowed in light of IRS' unconstitutional discrimination in favor of Scientologists.

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[8] As noted above, in accordance with Circuit Rule 36-3(c), we have attached to this brief a copy of the unpublished decision in Henson v. Internal Revenue Service, supra, as an appendix.

III. AT A MINIMUM, THE TAX COURT DECISION SHOULD BE REVERSED, AND THIS CASE SHOULD BE REMANDED TO THE TAX COURT FOR FURTHER FINDINGS.

We argued previously that if this Court has any doubt as to whether IRS exempted the Sklar children's schools from filing Form 990 because they are religious organizations, and is not otherwise persuaded that they are organized exclusively for religious purposes, it should remand this case to the Tax Court for findings concerning this; and if this Court is not persuaded that auditing, training and other qualified religious services in the Church of Scientology are jurisprudentially similar to the religious studies of the Sklars' children, or that IRS permits Scientologists to deduct as charitable contributions their payments for auditing, training and other qualified religious services, the Court should remand this case to the Tax Court for further findings on these issues. Initial Br. at 47-48.

The Government now makes a new argument:

> The deductions allegedly allowed for the Church of Scientology were for "auditing" and "training," activities pertaining to spiritual guidance of adults. . . . Taxpayers have not alleged that any school children are educated by the Churches of Scientology, let alone that deduction of tuition payments for such education is allowed by the IRS.

Govt Br. at 69.

There is no jurisprudential distinction between payments for religious instruction for adults and payments for religious

instruction for children. Moreover, IRS knows that "auditing" and "training" in the Church of Scientology are provided to children as well as adults; and the Sklars included this in their Offer of Proof in the Tax Court. R. 265, ¶¶10-11. IRS also knows that there is a network of K-12 schools linked with the Church of Scientology: Delphi Academy of Boston, Delphi Academy of Los Angeles (two campuses), Delphi Academy of San Diego (two campuses), Delphi Academy of Chicago, Delphi Academy of Florida, Delphi Academy of San Francisco and The Delphian School in Sheridan, Oregon. See http://www.delphisandiego.org/aboutUsCat6.html. We believe that these schools conduct "auditing" and "training" for their students, in addition to providing general studies. There is also evidence that Scientologists who send their children to these schools may deduct the fees they pay to the schools. See http://groups.google.com/group/alt.religion.scientology/browse_thread/thread/826835a386f2ee8c/73c66b27851c451e%2373c66b27851c451e.

We cannot prove these facts, because the Tax Court sustained the Government's objections to our conducting discovery concerning the Church of Scientology, and to our presenting at trial testimony and other evidence from the Church of Scientology. Therefore, if this Court questions whether children receive "auditing" and "training", or whether IRS

permits Scientologists to deduct as charitable contributions the tuition they pay to schools affiliated with the Church of Scientology, the Court should remand this case to the Tax Court for trial and findings concerning these facts.

CONCLUSION

For the foregoing reasons, and for the reasons stated in our Brief for Appellants, this Court should reverse the Decision of the Tax Court and enter judgment in favor of the Appellants. At a minimum, this Court should reverse the Decision of the Tax Court, and remand this case to that court for further findings concerning whether Emek and Yeshiva Rav Isacsohn are organized solely for religious purposes; and for full findings concerning whether the religious studies of the Sklars' children is similar to auditing, training and other qualified religious services in the Church of Scientology, and whether IRS permits Scientologists to deduct as charitable contributions their payments to the Church of Scientology for auditing, training and

other qualified religious services, and their tuition payments to schools affiliated with the Church of Scientology.

Dated: December 18, 2006

Respectfully submitted,

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Form 8. Certificate of Compliance Pursuant to Fed. R. App. P. 32(a)(7)(C) and Circuit Rule 32-1 for Case Number 06-72961

(see next page) Form Must Be Signed By Attorney or Unrepresented Litigant ***and attached to the back of each copy of the brief***

I certify that: **(check appropriate option(s))**

X 1. Pursuant to Fed. R. App. P. 32 (a)(7)(C) and Ninth Circuit Rule 32-1, the attached ~~opening~~/~~answering~~/reply/~~cross-appeal~~ brief is

☐ Proportionately spaced, has a typeface of 14 points or more and contains __________ words (opening, answering, and the second and third briefs filed in cross-appeals must not exceed 14,000 words; reply briefs must not exceed 7,000 words),

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__2. The attached brief is **not** subject to the type-volume limitations of Fed. R. App. P. 32(a)(7)(B) because

☐ This brief complies with Fed. R. App. P. 32(a)(1)-(7) and is a principal brief of no more than 30 pages or a reply brief of no more than 15 pages;

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__3. *Briefs in Capital Cases*

☐ This brief is being filed in a capital case pursuant to the type-volume limitations set forth at Circuit Rule 32-4 **and is**

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__4. *Amicus Briefs*

☐ Pursuant to Fed. R. App. P. 29(d) and 9th Cir. R. 32-1, the attached amicus brief is proportionally spaced, has a typeface of 14 points or more and contains 7000 words or less,

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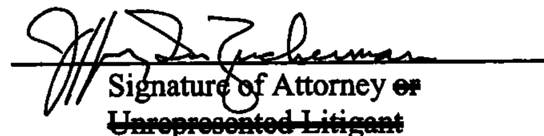
December 18, 2006
Date



Signature of Attorney ~~or Unrepresented Litigant~~

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APPENDIX

LEXSEE 2000 U.S. APP. LEXIS 23997

Analysis
As of: Dec 17, 2006

H. KEITH HENSON, Plaintiff-Appellant, v. INTERNAL REVENUE SERVICE, Defendant-Appellee.

No. 99-17038

UNITED STATES COURT OF APPEALS FOR THE NINTH CIRCUIT

2000 U.S. App. LEXIS 23997; 86 A.F.T.R.2d (RIA) 6386

September 11, 2000 n2, Submitted

n2 The panel unanimously finds this case suitable for decision without oral argument. See Fed. R. App. P. 34(a)(2).

September 25, 2000, Filed

NOTICE:

[*1] RULES OF THE NINTH CIRCUIT COURT OF APPEALS MAY LIMIT CITATION TO UNPUBLISHED OPINIONS. PLEASE REFER TO THE RULES OF THE UNITED STATES COURT OF APPEALS FOR THIS CIRCUIT.

SUBSEQUENT HISTORY: Reported in Table Case Format at: *2000 U.S. App. LEXIS 35786.*

PRIOR HISTORY: Appeal from the United States District Court for the Northern District of California. D.C. No. CV-98-21290-JW. James Ware, District Judge, Presiding.

DISPOSITION: AFFIRMED.

COUNSEL: H. KEITH HENSON, Plaintiff - Appellant, Pro se, Palo Alto, CA.

For INTERNAL REVENUE SERVICE, Defendant - Appellee: Jay R. Weill, Esq., USSF - OFFICE OF THE U.S. ATTORNEY, San Francisco, CA.

For INTERNAL REVENUE SERVICE, Defendant - Appellee: Kenneth L. Greene, Esq., Laurie A. Snyder, Attorney, DOJT - U.S. DEPARTMENT OF JUSTICE, Washington, DC.

For INTERNAL REVENUE SERVICE, Defendant - Appellee: Robert S. Mueller, III, Esq., U.S. Attorney Office, San Frnacisco, CA.

JUDGES: Before: WALLACE, FERNANDEZ, and McKEOWN, Circuit Judges.

OPINION:

MEMORANDUM n1

n1 This disposition is not appropriate for publication and may not be cited to or by the courts of this circuit except as may be provided by 9th Cir. R. 36-3.

[*2]

H. Keith Henson appeals pro se the district court's judgment dismissing, for lack of standing, his action alleging that the Internal Revenue Service ("IRS") violated the Establishment Clause by issuing a revenue ruling granting favorable tax deductions to members of the Church of Scientology. We have jurisdiction under *28 U.S.C. Section 1291*. We review de novo the district court's dismissal, *see San Diego County Gun Rights Comm. v. Reno, 98 F.3d 1121, 1124 (9th Cir. 1996)*, and we affirm.

Because any injury to Henson inflicted by the Church of Scientology is the result of independent action by a third party not before this court, the injury is too speculative to confer standing upon Henson to sue the IRS. *See Simon v. Eastern Kentucky Welfare Rights Org., 426 U.S. 26, 41-42, 48 L. Ed. 2d 450, 96 S. Ct. 1917 (1976)*. Furthermore, Henson lacked standing as a federal taxpayer because the first amended complaint failed to allege an injury resulting from Congress's exercise of power under the taxing and spending clause. *See Flast v. Cohen, 392 U.S. 83, 102, 20 L. Ed. 2d 947, 88 S. Ct. 1942 (1968)*.

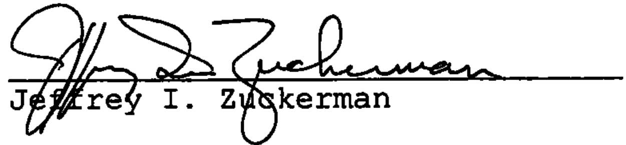
AFFIRMED.

CERTIFICATE OF SERVICE

I certify that a copy of the foregoing "REPLY BRIEF FOR APPELLANTS" was served on counsel for the Appellee by mailing the same, first-class, on December 18, 2006, in a postage-paid wrapper addressed to:

Kenneth L. Greene, Esquire
Ellen Page Delsole, Esquire
Appellate Section
Tax Division
U.S. Department of Justice
P.O. Box 502
Washington, D.C. 20044

Dated: December 18, 2006



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