DETAILS OF SCIENTOLOGY CLOSING AGREEMENT SLOWLY COMING OUT.

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Following the recognition by the IRS of the tax-exempt status of numerous Scientology organizations on October 1, 1993, Tax Analysts, in a Freedom of Information Act request dated November 10, 1993, sought the underlying closing agreement, contending that it was part of the administrative record in these cases and hence subject to disclosure under section 6104. The IRS denied the request, contending that the closing agreement contained return information not subject to disclosure under section 6103.

Tax Analysts then filed suit in the U.S. District Court for the District of Columbia, seeking release of the closing agreement and all other closing agreements pertaining to exempt organizations since December 31, 1992. In response to interrogatories, Jonathan Jackel,who is the trial attorney with the Tax Division of the Department of Justice assigned to the case, did lay out what appears to be the government's main defense to release of the closing agreements: "All information described by plaintiff that is not available to the public by virtue of I.R.C. sections 6104 or 6110 is confidential return information under section 6103."

Section 6103 provides that "returns and return information shall be confidential." Section 6104, however, provides for the public disclosure of information submitted to the IRS by tax-exempt organizations. Hence, one of Tax Analysts's arguments is: If the IRS agreed to recognize Scientology organizations as tax-exempt under a closing agreement, should that agreement not be subject to public disclosure under section 6104? The Service, perhaps recognizing the logic of that argument, has forcefully asserted that even though the exemption rulings followed the closing agreement, the agreement did not serve as the basis for the rulings. However, the off-track processing by the Service in advance of, and after, the final "formal" exemption applications were filed leaves that assertion unsupported.

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processing by the Service in advance of, and after, the final "formal" exemption applications were filed leaves that assertion unsupported.

Depositions Start Telling Story

Following the interrogatories, Tax Analysts deposed five senior IRS officials involved in some way with the Scientology closing agreement. "I'm not aware of any direction ever being given thattold a tax law specialist not to review an administrative file in preparing their recommendation on a case," according to Jeanne S. Gessay, chief of the IRS ruling branch to which the Scientology exemption applications were assigned. Yet that was what washappening in her branch involving tax law specialists under her supervision.

The limited scope of branch review was outlined in a file memo prepared by tax law specialist Terrill Berkovsky in the case of the Church of Scientology, Western United States: "The issues regarding inurement, private benefit, public policy, and whether the organization is involved in commercial activities have not been addressed in this file memorandum as the negotiation committee involved in the closing agreement made the determination that there was no inurement, private benefit, or commercial activities that would prohibit recognition of exempt status. This request to affirm organization's exempt status was processed as part of settlement negotiations and in accordance with special instructions from the negotiations committee. The committee was chaired by Howard Schoenfeld."

Yet, according to Jay Rotz, executive assistant to the director of the IRS Exempt Organizations Division, who did review the applications, the tax law specialists were not under instructions to ignore issues of inurement, private benefit, and commerciality. But he did say that "by the time the applications were submitted, it's my understanding that those issues had been resolved at that point."

Later, Howard Schoenfeld, special assistant in the IRS Office of Assistant Commissioner (Employee Plans and Exempt Organizations), did confirm that directions had been given to tax law specialists in Gessay's branch. Schoenfeld was asked: "Have you ever directed a tax law specialist not to examine an application for such technical issues?" referring to "inurement, private benefit and commerciality" . He responded in his deposition: "There came a time when I did ask that the tax law specialist not make or consider any substantive matters relating to an application."

At Jackel's behest, Schoenfeld did offer the following clarification: "In the particular situation, the responsibility, the substantive responsibility, did not belong to the tax law specialist for making substantive decisions in the case. They were only responsible for the procedural aspects of the case. So that's why the request was made as it was. The responsibility for all the decisions in the case was not the responsibilities of the persons who actually handled and processed the case for procedural purposes."

James J. McGovern, the current assistant commissioner (EP/EO), testified in the same vein. He was asked: "Did the negotiations committee issue special instructions regarding the processing of the Scientology exemption applications which ultimately led to the issuance of the favorable exemption ruling letters?" McGovern responded: "They the people who normally process ruling letters were advised that those matters technical issues had been reviewed and a decision has been made with respect to them." He was then asked: "Prior to those applications being received by the tax law specialists?" In what appears to be a significant admission, McGovern answered affirmatively.

Who Signed for Whom?

Gessay admitted that the exemption rulings to the Church of Scientology had her signature on them, but she said she had no responsibility for their review and took no part in the review process. Instead, responsibility rested with Rotz.

Rotz confirmed that he had signed for Gessay, but could not recall if the assistant commissioner (EP/EO) signed off on those ruling letters. Nor was Rotz familiar with the closing agreement with the Scientologists. He

explained that his role was strictly procedural, that the applications had been "physically handed" to him by Schoenfeld, and that he had received special instructions.

Asked if the Scientology applications had been "considered and reviewed in accordance with these typical procedures," Rotz said no. Instead, he admitted that special procedures were adopted for the handling of the Scientology applications.

Interestingly, the EO Division director, Marc Owens, who is Rotz's immediate superior, was recused from the processing of the Scientology applications. When asked if he was "aware of how your division handled and processed the applications submitted by the Scientology applicants," he answered no.

Schoenfeld did admit to signing off on the ruling letters, along with the entire negotiating committee. He admitted that the major decisions were made by the negotiating committee: "I just want to reiterate that the decisions, or the substantive decisions, were by the negotiating committee, including me -- myself -- as to all matters of substance in the handling of the exemption applications." But Schoenfeld would not respond to queries whether there was any White House or Treasury Department contact or correspondence regarding the applications.

Schoenfeld conceded that the processing that occurred in the exempt organizations division was strictly procedural, not substantive: " The tax law specialists were to prepare the ruling letters to insure that they would satisfy all the procedural requirements that were necessary and outstanding at that time." The tax law specialists were not to evaluate the Scientology applications for issues of inurement or "any other substantive issues," including issues of private benefit and commerciality. They were so advised on his authority, he admitted.

Decision Time at Issue

The IRS contends that the decision to grant exemption to the Scientologists was made after August 30, 1993, when it appears that the actual decision to grant exemption must have been made before that date -- as part of the closing agreement with the Scientologists. When asked about the IRS review of the Scientology applications, Schoenfeld at least admitted there was some pre-August 30, 1993, information on which the IRS relied: "That review took place at the time of the receipt of the exemption applications and including times prior to the receipt of those exemption applications when matters relating to tax-exempt status and other issues were under consideration by the Internal Revenue Service." McGovern said the technical review was a two-year process, which obviously exceeded the six weeks from receipt of the final exemption applications (August 18, 1993) to issuance of the favorable exemption rulings (October 1, 1993). Two years, on the other hand, does match the time the negotiating committee was in existence.

But Schoenfeld would not, on advice of counsel, answer whether any of the Scientology applicants were asked to enter into a closing agreement as a condition precedent to the issuance of a favorable letter ruling. Such an admission would strongly suggest that the decision to grant exempt status had been made before August 30, 1993 -- that is, two weeks after receipt of exemption applications -- and support release of the closing agreement under section 6104.

The government's defense is to refuse to answer questions pertaining to the closing agreement on the basis that section 6103 compels IRS silence. "I'm going to object and instruct the witness not to answer questions about negotiations between Scientology and the Internal Revenue Service," was a familiar objection voiced by Jackel.

Section 6103

The government is also taking an expansive view of section 6103, which pertains to "returns and return information," defined in section 6103(b)(2). IRS counsel Margo Stevens seems especially liberal in her interpretation of section 6103: "Return information is not just having to do with a return." She was challenged by Bill Lehrfeld, counsel for Tax Analysts: "It [section 6103] has to protect return information. If there's no return, are you telling me that there is return information if there is no return?" Undeterred, Stevens replied: "Yes, that may be so."

The government is even claiming that some information in the administrative file is covered by section 6103. In particular, the Justice Department was surprised by the discovery in the administrative file of a letter from then Assistant Commissioner (EP/EO) John E. Burke to the Scientologists. In that January 1992 letter, Burke states: "You [the Scientologists] indicated that you do not want the materials submitted in the ongoing discussions to be placed into the administrative record of any of the [exemption] applicants. While I have some concerns about that, I do not want this procedural issue to become a stumbling block to progress in our discussions."

Burke then goes on to make a statement that was the subject of heated exchanges during the depositions of Schoenfeld and McGovern. McGovern had been on the negotiating committee with Schoenfeld when he was associate chief counsel (EB/EO). According to Burke in his letter, "If the materials you provide sufficiently address our questions and concerns so that we are able to issue favorable determination letters, we will need to put at least some of that information into an administrative record. As part of our dialogue, we can discuss the content of the administrative records."

The statements by Burke in his letter to the Scientologists should be contrasted with the deposition statements of Owens, director of the EO Division -- the division with primary responsibility for issuing exemption rulings. When asked about the administrative record that must be made available to the public under section 6104, Owens said under oath: "My division procedures would require that any documents submitted by the taxpayer or their representative, or sent by the Service to the taxpayer or their representative, as part of the processing of the application for exemption, would be part of the administrative file and part of the administrative record, the public record in the case."

In particular, Owens was asked whether the following statement in the Burke letter is consistent with his division's policies: "If the materials you provide sufficiently address our questions and concerns so that we're able to issue you favorable determination letters, we will need to put at least some of that information into an administrative record. As part of our dialogue, we can discuss the content of the administrative records." Owens said no.

But Schoenfeld, in his deposition, said the above statement is consistent with IRS policy. Pressed on this point, Schoenfeld, one of the drafters of the statement, said: "Your statement contains an absolutely erroneous premise . . . that the information requested related only to the exemption application."

Jackel, recognizing the corner his clients were being painted into, interjected: "I realize that temporally we have a lot of complications here. We're talking about a letter that was written in January of 1992, and we're talking about organizations whose successful application for exempt status wasn't filed until after that date."

The Key Question

Plaintiff's counsel Bruce Stern then asked Schoenfeld the $64,000 question: "Is it your understanding that by the terms of this letter the Internal Revenue Service would not place all materials submitted in support of these exemption applications in their administrative records?" Schoenfeld answered no. That may be his good faith understanding, but it does not answer the question whether materials were submitted in support of unsuccessful applications that were not, but should have been, in the administrative record of the "final" applications.

In response to a follow-up question, Schoenfeld explained, "The Internal Revenue Service was receiving materials that, in part, related to an exemption application matter, but also was requesting and receiving information that related to other pending matters before the Internal Revenue Service."

Later, after having admitted that a review of all information before the IRS was made to determine what information needed to go in the administrative record, Schoenfeld was asked, "Did counsel for the Scientologists or any representatives of the Scientologists take part in the determination as to what materials would be placed in the administrative record subject to public review?" He responded, "The determination was made by the Internal Revenue Service." Unaddressed was whether such a determination was or was not in accord with the Burke letter's statement that "As part of our dialogue, we can discuss the content of the administrative records."

When Schoenfeld was asked about the Burke letter in this context, Jackel cut off any response: "Well, then, you're asking him to interpret what the law is, and that's beyond the scope of his testimony. The question of what should have been done in a particular case is the kind of opinion evidence that he is not authorized to testify on. If you ask him what the procedures are, generally, that's fine. How they apply in a particular case is, in essence, expert testimony."

The Unanswered Question

The question of who made the final decision to recognize the Scientologists as tax-exempt remains unanswered. When Owens was asked, he said, "I don't know." When Schoenfeld was asked if it was the commissioner or assistant commissioner (EP/EO), he said, "I decline to answer."

As for the processing of the Scientology applications, it was unusual. Asked if he was aware of any situation in which a tax law specialist has been directed not to examine an application for issues of inurement, private benefit, commerciality, and public purpose, Owens said, "I'm not aware of such an instruction having been given." (That is what happened in the Scientology cases.) Asked if it would be unusual for a tax law specialist to receive such instructions from his superiors, he said, "I would find that to be unusual."

Rather than defend its conduct in this controversial case, the IRS appears to be relying on section 6103 to shield its "unusual" actions from public scrutiny. The government's argument is a simple one. If it disclosed information regarding the Scientology exemption rulings in the sanitized administrative file, it is ipso facto section 6104 information; if it did not, then it is ipso facto section 6103 information.

A Novel Defense

Basically, the government's position appears to be that any information not required to be made available under section 6104 is covered by section 6103 (which, by its terms, is supposedly limited to returns and return information). "Any information that's not required to be disclosed under 6104 is privileged," is the way Jackel put it. Nevertheless, IRS officials said that IRS Form 1023 is not a return.

The argument seems to be that the government has unfettered discretion to decide what is privileged information (section 6103) and what is not (section 6104). When pressed on this interpretation, Stevens replied: "I'm not going to accept, for this discussion here -- which I think is totally inappropriate in any event -- to battle on the legal issues that are . . . for the court to decide."

Lehrfeld's response was, "Well, I don't know that counsel's byplay is ever immaterial for a court's consideration. . . . The theory of our case is that a document that is required to be submitted during the application process, and which is required by the National Office in advance of the issuance of a favorable ruling, supports the exemption application and therefore is disclosable under 6104, because the ruling would not have been issued, but for the filing of that document."

Faced with that postulation of plaintiff's position, Jackel confirmed the government's ipso facto posture in this case: "If the Service has not determined under the procedures of 6104 that the document must be placed in a public file, then it is our position that it is 6103 information." The only problem with this position, if accepted by a court, is that it will give the IRS complete freedom to decide what information is subject to public scrutiny and what information is not. One would assume that the government will always opt for the least possible amount of disclosure in every case.

The Mysterious Negotiations Committee

As for the negotiations committee, which appears to have done the heavy lifting in the Scientology cases, the government did not initially want to even concede its existence, until Schoenfeld, in his deposition, faced with evidence of its existence, admitted he served on the negotiating committee.

But Jackel would not allow Schoenfeld to explain the role of this onetime negotiating committee: "The guidelines for the negotiating committee are whatever the situation dictates," was Jackel's terse explanation. But later, McGovern, without Jackel's objection, responded to this question: "Was the goal of the negotiating committee to negotiate a resolution to issues involving the exempt status of the Church of Scientology or its affiliated organizations?" According to McGovern, "The goal of the committee was to address a myriad of issues of outstanding disputes between the church and the Service, one of which was exempt status."

From a document in the administrative record, it appears that the members of the negotiating committee were (in addition to McGovern and Schoenfeld): Bob Gardiner (then senior projects analyst in the office of EP/EO field compliance); Beth Purcell (assistant branch chief in the office of the associate chief counsel (EB/EO)); and Steve Miller (then special counsel to the associate chief counsel (EB/EO)). The problem here for the IRS, which the agency does not want to admit, is that it appears that the negotiating committee made a decision to recognize the exemption of approximately 25 Scientology applicants who then submitted the "final" exemption applications, which were then reviewed only for procedural correctness by the exempt organizations division.

The most germane testimony on this issue was by McGovern in response to questions asked by Stern.

Stern: "Mr. McGovern, is it typical for the IRS to make a determination with respect to an organization's exempt status prior to the date the organization's exemption application is filed?"

McGovern: "No."

Stern: "Are you aware of any circumstances under which the IRS has made a determination with respect to an organization's exempt status prior to the date its exemption application was filed?"

McGovern: "No."

Stern: "Are you aware of any situation in which the National Office has determined that it will recognize an organization as exempt under section 501(c)(3) prior to the date the organization's approved exemption application (an exemption application to which a favorable ruling was issued in response to) was filed?"

McGovern: "No."

Stern: "Just so we're clear, the IRS has never made a determination to recognize an organization as exempt under section 501(c)(3) prior to the date the organization's approved exemption application was filed?"

McGovern: "Not to the best of my knowledge."

What is not being differentiated is the actual decision to recognize exemption and the pro forma decision to issue a ruling to recognize exempt status. As noted above, the depositions strongly support the proposition that the only review conducted in the exempt organizations division was procedural, and that all substantive decisions were made by the negotiating committee.

Jackel would not let Schoenfeld say who directed that the negotiating committee be formed, although there are reports that then Commissioner Fred Goldberg directed its formation after meeting with Scientology representatives. Nor would Jackel let McGovern address the question whether Goldberg directed its formation.

When Was the Decision Made?

As noted above, at issue is whether the IRS promised exemption to Scientology organizations before the submission of the Form 1023 applications that appear in the administrative record.

Schoenfeld said no, but later he refused to answer, at the direction of counsel, the following question: "Since 1991, has the IRS conditioned its issuance of a 501(c)(3) ruling letter to an organization on the organization's agreement to be bound by the terms of a previously executed closing agreement?" Owens responded to this question by saying, "In the cases in which I'm familiar . . ., my recollection is that the closing agreements were

necessary for purposes of arriving at the ultimate decision in the case." His answer, however, was not directed to the Scientology cases because Owens was not involved in them.

McGovern would not answer, on advice of counsel, this question: "Did the closing agreement provide that the IRS would recognize the Scientology applicants, or any of them, as exempt under section 501(c)(3)?" But McGovern did answer affirmatively this question: "Through this agreement, did the IRS resolve the outstanding issues regarding Scientology applicants' exemption applications?"

And Jackel did let Schoenfeld answer this question: "Was the working group charged with the responsibility of determining whether the Scientology applicants would be recognized as exempt under section 501(c)(3)?" Schoenfeld said, "That was part of the charge." Interestingly, McGovern's response to the same question was the same: "That was part of the charge."

Somewhat surprisingly, in light of his previous testimony, McGovern did answer affirmatively this question: "Since 1991, has the IRS more than once used a closing agreement to resolve outstanding issues regarding an organization's future exempt status?" McGovern: "I believe so." This question is significant because an affirmative response indicates that at least part of the closing agreement should have been part of the administrative record in any such case. The testimony of Schoenfeld indicates that the Scientology cases were such cases.

The parties are preparing motions for summary judgment, due June 30.

Scientology
versus the IRS

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