

Scientologists' Loss of Tax-Exempt Status Upheld by U.S. Court

By KIM MURPHY, Times Staff Writer

Concluding that L. Ron Hubbard, founder of the Church of Scientology of California, had "unfettered control" over millions of dollars in church assets, a federal appeals court Tuesday upheld the revocation of the church's tax-exempt status.

In a ruling that rejected nearly every argument the church had raised, the U.S. 9th Circuit Court of Appeals said there is evidence that the late church founder held millions of dollars of church funds in private trust funds, Swiss bank accounts and in a file cabinet on his Mediterranean-based yacht.

The court also concluded that a profit-making Panamanian company created by Hubbard and his wife in 1968 was a "sham corporation" that received more than \$3.5 million in church funds between 1971 and 1972.

As a result of the decision, written by Judge Thomas Tang for a three-member appellate panel, the church will be required to pay \$1.43 million in back taxes and penalties accrued during its long-running tax feud with the government.

The case had been closely watched by a number of religious organizations, who feared the Internal Revenue Service's clamp-

down on the church's revenue-raising activities—including books, pamphlets and a variety of spiritual services for its members—could spell trouble for other churches.

The American Council of Unregistered Churches, the American Forum for Jewish Christian Cooperation, the Protestant Council for Churches and Clergy, the Freedom Defense Council and the World Council on Religious Liberty all filed briefs on behalf of Scientology.

"The reason they filed was that if these court decisions come down against this one church, it's going to have an impact on all other churches and their ability to raise money," said Glendale attorney Gerald McNally Jr., representing the church organizations.

"As congregations shrink, churches have to turn to more innovative ways of raising donations, and if the only way that's permitted for a church to raise donations is to pass the plate on Sunday mornings, its hands are tied," McNally said.

The Rev. Heber Jentzsch, president of the Church of Scientology International, refused to accept Tuesday's ruling as an outright defeat, contending that "we won

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something very major."

Despite the 9th Circuit judges' conclusion as to the church's tax-exempt status, Jentzsch pointed out, they found that it was a bona fide religious organization and "that is something we have fought the IRS for for 30 years."

(The court said the church's status as a bona fide religion was uncontested by the IRS, but was not enough to maintain the church's tax-exempt status in light of its methods of operating.)

Although that "victory" has cost the church \$1.3 million in taxes (plus interest) for the years 1970-72, Jentzsch said, "We're now ready to take on the IRS for the years 1973 and 1974. We're the

only group in America with the guts to stand up against the IRS."

Jentzsch said the decision was also good in that "it shows that the IRS indeed has been hostile to the Church of Scientology."

In its 18-year-long battle with the federal government over tax-exempt status, the church had compared Hubbard's stewardship over church assets to pastors all over America who collect money from parishioners and hold it for church uses.

But the court said it found those arguments "unpersuasive."

"Unlike the typical Saturday or Sunday when parishioners donate their money to the church, here the church transferred millions of dollars to bank accounts controlled by

a private individual who had no official responsibility for managing church assets," the court concluded, adding that there was "little documentation" to show the money was actually spent on bona fide church activities.

Hubbard, who died last year, officially resigned as head of the church in 1966, but the U.S. Tax Court, in its original findings in 1968, found that he continued to exert "significant control" over the church by setting policy and approving all financial planning.

Between 1970 and 1972, the three tax years at issue in the case, the court found that Hubbard and his wife received a total of \$185,577 in salary from the church.

While that amount was not ex-

cessive enough to invalidate the church's tax-exempt status, the court did raise questions about an additional \$104,618 in royalty payments to Hubbard in 1972 on all church publications, even those which he did not author.

In order to win tax-exempt status, churches must prove that no part of their net earnings went to the benefit of any private shareholder or individual. And it was that requirement on which the court concluded that the church had run afoul.

In addition to the royalty payments, the court noted the money the church spent to maintain Hubbard and his wife on the church's yacht in the Mediterranean and an estimated \$2 million that was

transferred from the Panamanian corporation to a file cabinet on the yacht to which Hubbard's wife held the only keys.

"The court concluded that these *indicia*, when viewed in light of the self-dealing associated with them, coupled with the church's failure to carry its burden of proof and disclose the facts candidly, proved conclusively that the church was operated for the benefit of L. Ron Hubbard and his family," the appeals panel said of the tax court's initial decision, which it upheld.

"Because it is unnecessary to our decision, we express no opinion on whether supporting a church's founder and his family aboard a yacht cruising the Mediterranean constitutes a reasonable church expense," the court added.

In a finding that could be important for other churches watching

the case, the court held that financing church operations through the sale of religious literature does not necessarily violate the requirements for tax exemption.

But in this case, where there is evidence that Hubbard used the church to generate copyrighted literature and market his products, "the payments . . . cross the line between reasonable and excessive," the court ruled.

John Huston in Hospital

FALL RIVER, Mass. (UPI)—Oscar-winning director John Huston, 80, was hospitalized with emphysema Tuesday as he was about to begin filming his part in a new movie on location in the resort town of Newport, R.I., officials said. "His condition is grave," a spokesman said.