

Question 8

- 8. Please explain why you believe Bridge Publications, Inc. and New Era Publications International ApS qualify for tax exemption under Section 501(c)(3).

FACTS

The Scientology religion is based on the research, writings, and recorded lectures of L. Ron Hubbard. These materials constitute the Scriptures of the religion and encompass over 300 books, hundreds of course material packs, thousands of individual policy letters and issues, over 3,000 taped lectures, 42 filmed lectures or demonstrations by Mr. Hubbard and approximately 100 films written by Mr. Hubbard to disseminate the religion and to train ministers in the application of Scientology principles and technology. As mother church of the Scientology faith, Church of Scientology International (CSI) is responsible for ensuring the availability of the Scriptures to Scientologists world-wide.

CSI fulfills this duty through an international network of publishing organizations operated exclusively in furtherance of Scientology religious purposes. The international publishing network consists of two primary organizations, Bridge Publications, Inc. (Bridge), and New Era Publications International ApS (NEP) and its subsidiaries.

Bridge, a California corporation, publishes and distributes religious books and other written scriptural materials in the United States and Canada.^{1/} It also publishes and distributes Mr. Hubbard's fictional works in these countries. It has a staff of approximately 70 individuals and an annual budget of approximately \$24 million, based on its annual disbursements for the most recent year for which financial statements are available. International Publications Trust (IPT), a religious trust organized for the exclusive purpose of disseminating Scientology religious practice and faith, owns all of Bridge's outstanding stock.

NEP, a Danish corporation, publishes and distributes religious books and other written Scriptural materials in countries other than the United States and Canada. It also publishes and distributes Mr. Hubbard's fictional works in these countries. It has a staff of approximately 88 individuals and a budget of approximately \$35 million, based on its consolidated annual disbursements for the most recent year for which financial

^{1/} For the most part, Bridge contracts out actual printing of books.

statements are available. IPT owns all of NEP's outstanding stock. NEP has several wholly owned subsidiaries which undertake its publishing and distribution activities in certain countries where the scale of its operations or other feasibility concerns require a local organization. These subsidiaries have modest staffs and are located in the United Kingdom, Italy, Germany, France, Japan, Spain, Australia and Israel.^{2/}

Bridge and NEP have always operated exclusively for religious purposes. In 1988, Bridge and NEP amended their organizational documents to adopt provisions comporting with the organizational test of section 501(c)(3).^{3/} However, since NEP's Danish counsel believed that references to United States statutory provisions would be difficult or impossible to enforce in Denmark, NEP's provisions define rather than refer to section 501(c)(3). These amendments merely memorialized past and existing practices. Neither organization has ever made any distribution of dividends or net earnings or paid any unreasonable compensation.

Bridge and NEP work in connection with and under the direct supervision of CSI staff personnel responsible for disseminating the Scriptures throughout the world. Pricing for Scriptural materials is set by CSI or under its close scrutiny. Scientology ecclesiastical policy requires that prices: (1) be affordable to a broad segment of the general public; (2) enable the churches and publishing organizations to recover their costs of production or delivery; and (3) produce a sufficient return to enable the publisher or church to remain operational so it can continue performing its dissemination function, replenish stocks if necessary, and expand to minister to and provide for an ever growing congregation.

In general, NEP and Bridge distribute their religious publications directly to Scientology churches for distribution in bookstores usually located in the lobby or reception area of Scientology churches. These church bookstores have primary responsibility for disseminating Scientology Scriptures and other religious material to church parishioners.

NEP and Bridge sell introductory Scriptural texts such as Dianetics: The Modern Science of Mental Health and Scientology: The Fundamentals of Thought and Mr. Hubbard's fictional works through commercial retailers, but sales are limited. The

^{2/} The Israeli subsidiary has no staff members and is dormant.

^{3/} The Bridge amendments separately satisfy the requirements of section 508(a).

objective of these limited sales through commercial retailers is to create interest in Mr. Hubbard's works and thereby to disseminate the religion. Since readers tend to follow the works of authors they enjoy, crossover readership often interests the reader in Scientology. For example, several of Mr. Hubbard's novels were released in 1986 and made the New York Times Bestseller List. As a result, sales of Dianetics: The Modern Science of Mental Health and Scientology: The Fundamentals of Thought and other Scriptural material jumped sharply in the late Winter and early Spring of 1987.

Sales of Mr. Hubbard's fictional work constitute a very small portion of Bridge's and NEP's total sales and result in no net profit. Gross revenue from sales of Mr. Hubbard's fictional works in 1992 amounted to approximately 8% of Bridge's total gross revenue; gross revenue from sales of religious works amounted to approximately 92%. NEP's gross revenue split (exclusive of its subsidiaries) is less than 1% for fiction and greater than 99% for religious works.

Expenditures by Scientology-affiliated organizations for religious and social betterment programs dwarf net revenues from the publication organizations' operations on a year-by-year basis. For example, in 1989, Bridge's and NEP's combined net revenue from publication (exclusive of NEP's subsidiaries) was barely \$1.5 million.^{4/} Focusing solely on CSI, disbursements in the same year for CSI's religious program amounted to \$46.8 million.

LEGAL ANALYSIS

Section 1.501(c)(3)-1(e), Income Tax Regs., provides:

In General. An organization may meet the requirements of section 501(c)(3) although it operates a trade or business as a substantial part of its activities, if the operation of such trade or business is in furtherance of the organization's exempt purpose or purposes and if the organization is not organized or operated for the primary purpose of carrying on an unrelated trade or business, as defined in section 513.

The regulations plainly permit organizations to retain their exemption while engaging in a trade or business, so long as these operations are related to their exempt purpose. The legislative history of the Code provisions on unrelated business income makes

^{4/} NEP's net revenue for 1989, determined on a consolidated basis, amounted to 2.480.171 Danish kroner. The exchange rate on December 31, 1989, was 6.6 kroner to the dollar.

clear that this concept applies to the publication of religious materials, so long as the activity is carried on in connection with a church. When Congress decided to subject churches to the unrelated business income tax in 1969 the House Ways and Means Committee issued a report targeting businesses operated by religion in competition with commercial entities, including religious bookstores. See H.R. Rep. No. 413, 91st Cong., 1st Sess. 47 (1969). In a written statement to the Senate Finance Committee, William Consedine, General Counsel of the United States Catholic Conference, warned that seemingly ordinary business activities, particularly publishing, may actually be a way of carrying out traditional church functions, such as proselytism, which should not be subject to tax:

The Joint Statement of the National Conference of Churches and the United States Catholic Conference contained a request the unrelated business income be defined in such a way that it does not include any activity related directly or indirectly to the tenets and traditional functions of the church including especially cemeteries, institutions for the care and training of the unfortunate, print and distribution of religious publications with or without advertising, fundraising activities and the sale under church auspices of religious articles and pamphlets.

For example, in justifying the need for extending the tax on unrelated business income to include churches, the House Committee Report, on page 47, cites as an example of a business activity of a church, the operation of a chain of "religious bookstores." We submit that the printing, distribution and sale of religious publications is a related function of a church. The mere fact that a profit-making, non-religious corporation may be engaged in the same activity in competition with a church does not alter the fundamental fact that a church which seeks to spread a religion and the Word of God through the printing and sale of religious books is truly engaged in a related, religious function.

Tax Reform Act of 1969: Hearings Before Senate Finance Committee, 91st Cong., 1st Sess. 2108-09 (1969) (Statement of William E. Consedine, General Counsel, United States Catholic Conference) (emphasis added).

Congress addressed each of these concerns. In extending the UBIT to churches, it specifically exempted business activities with special religious significance "carried on in connection with" a church from the UBIT:

In the case of churches, the committee intends that the term unrelated business income does not include the operation and maintenance of cemeteries, the conduct of charitable institutions, the sale of religious articles and the printing, distribution and sale of religious pamphlets, tracts, calendars, papers, books and magazines with a substantial religious content (even though the document might contain a small amount of advertising,) as long as these activities are carried on in connection with the church.

S. Rep. No. 552, 91st Cong., 1st Sess. 71 (1969), reprinted at 1969-3 C.B. 469.

Congress' clear intent was that the sale of religious articles and books constitutes a business activity related to the exempt purposes of a church so long as it is "carried on in connection with the church." Congress did not impose any special requirement on these activities other than that literature have "substantial religious content." So long as publication of religious materials is connected to a church and the published materials have substantial religious content, the business activity will be inherently related to exempt religious purposes.

The courts have had ample opportunities to address the exempt qualification of organizations that publish religious materials.^{5/} The cases fall into two classes: (1) cases involving a publishing organization, the sole activity of which is the publication of religious materials and which is not

^{5/} See, e.g., Presbyterian and Reformed Publishing Co. v. Commissioner, 743 F.2d 148 (3d Cir. 1984), rev'g 79 T.C. 1070 (1982); Elisian Guild, Inc. v. United States, 412 F.2d 121 (1st Cir. 1969); Scripture Press Foundation v. United States, 285 F.2d 800 (Ct. Cl. 1961), cert. denied, 368 U.S. 985 (1962); Christian Manner International, Inc. v. Commissioner, 71 T.C. 661 (1979); Pulpit Resource v. Commissioner, 70 T.C. 594 (1978); Saint Germain Foundation v. Commissioner, 26 T.C. 648 (1956), acq., 1956-2 C.B. 8; Alive Fellowship of Harmonious Living, T.C. Memo. 1984-87; A.A. Allen Revivals, Inc. v. Commissioner, T.C. Memo. 1963-281; Incorporated Trustees of the Gospel Worker Society v. United States; 510 F.Supp. 374 (D.D.C. 1981), aff'd without opinion, 672 F.2d 894 (D.C. Cir. 1981), cert. denied, 456 U.S. 944 (1982); Fides Publishers Ass'n v. United States, 263 F.Supp. 924 (1967).

affiliated, either formally or informally, with any particular church^{6/}, and (2) cases involving an organization whose publishing activities are a related religious function through their connection to a church.^{7/} Organizations described in the second class fall within Regulations Section 1.501(c)(3)-1(e)(1), because publication of religious materials is carried on in connection with a church. Organizations described in the first class, unaffiliated with a specific church or religious denomination, do not come within the regulations, and cases involving them are uniformly distinguishable on this basis.

The distinction between the two classes was clearly drawn in the two decisions in Presbyterian and Reformed Publishing. In the lower decision, the Tax Court viewed the petitioner as a wholly independent organization and found that its sole activity was publishing religious materials. The court concluded that the petitioner had transformed into a nonexempt concern. Id. at 1083-87. In reaching this conclusion the court stated:

Further, petitioner was not affiliated or controlled by any particular church organization and this nondenominational character "contributes to the resemblance between its publishing activities and those of commercial, nonexempt publishers of Christian literature with whom * * * [it] competes." Incorporated Trustees of the Gospel Worker Society v. United States, supra at 379 n. 16.

Id., 79 T.C. at 1086.

On appeal, the Third Circuit noted that the Tax Court appeared to have ignored evidence that the publishing organization was related to another organization with a substantial religious program. It, therefore, assumed that the lower court had refused to impute the exempt activities of the closely related religious organization in the absence of evidence of formal affiliation. Id., 743 F.2d at 156. Whether formally affiliated or not, in the Third Circuit's view, the publishing organization's close relationship to another organization with a

^{6/} Elisian Guild, Scripture Press, Presbyterian and Reformed (opinion of the Tax Court), Christian Manner International, Pulpit Resource, Incorporated Trustees of the Gospel Worker Society, Fides Publishers Ass'n

^{7/} Presbyterian and Reformed (opinion of the Court of Appeals for the Third Circuit), Saint Germain Foundation, Alive Fellowship of Harmonious Living and A.A. Allen Revivals, Inc.

substantial religious program was sufficient to guarantee its exemption, see id., despite its resemblance to the typical commercial religious publisher in most, if not all, other respects. 79 T.C. at 1086. Thus, as long as a publishing organization's activities are related to a church, exemption will follow. Id. Accord, St. Germain Foundation, supra (Sale of religious literature by affiliated publishing organization was related to church's religious program; therefore, organization was exempt); Alive Fellowship of Harmonious Living, supra (Church was exempt where its sale of religious literature was related to its religious program); A.A. Allen Revivals, Inc., supra (Church was exempt where its sale of religious literature was related to its religious program). Bridge's and NEP's publication activities are conducted exclusively for the advancement of Scientology. Accordingly, Bridge's and NEP's publishing activities are clearly carried on in connection with a church, and their publishing activities are undertaken exclusively for exempt purposes.^{8/}

Bridge and NEP clearly fall into the second class: they are closely affiliated with Church of Scientology International and all other Scientology religious organizations. Their sole function is to publish material critical for the practice of the Scientology religion for the benefit of the churches and their parishioners, and they perform their functions under CSI's direct supervision and control. Unlike the publishing organization in Presbyterian and Reformed and Incorporated Trustees, BPI and NEP are both affiliated and controlled by CSI and are exclusively of one denomination. Their publishing activities are crucial to the Scientology religion and, thus, must be viewed in relation to the religion as a whole.

^{8/} The publication of Mr. Hubbard's fictional works is not unrelated to Scientology's religious program, because it serves as a means of introduction for new parishioners.