

**IN THE UNITED STATES CLAIMS COURT  
CASE NO. 581-88T**

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**CHURCH OF SPIRITUAL TECHNOLOGY, Plaintiff,**

**V.**

**THE UNITED STATES, Defendant.**

**PLAINTIFF'S PROPOSED FINDINGS OF FACT**

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**INTRODUCTION**

This document represents the proposed findings of fact of plaintiff, Church of Spiritual Technology ("CST"), in support of its brief on the merits filed herewith. In these proposed findings and in its brief, CST has used the identification and pagination conventions in defendant's February 5, 1990, Motion for Leave to Give Notice of Citation Forms. Although these proposed findings incorporate portions of CST's prior proposed findings made in connection with defendant's

motion to dismiss and CST's cross motion, no cross references to corresponding paragraphs of CST's prior proposed findings have been included CST has prepared a separate Appendix (in 3 volumes) of relevant record materials which support these findings.(note 1).

The structure of section 7428 dictates that the facts in CST's administrative record must be accepted as true.(note 2) Thus, the facts set forth in these proposed findings must be accepted as true unless the record does not support the proposed finding or the record contains other facts which contradict the proposed finding.

It should be noted that CST's administrative record and proposed findings cover a larger period of time than the typical section 7428 case. Ordinarily, the IRS's ruling with respect to a newly-formed applicant will be based only on its proposed activities. Here, however, because of the lengthy administrative proceeding prior to the IRS's ruling on CST's application, CST's record includes not merely its proposed activities but evidence of its actual activities from its formation through April 30, 1987, the end of its 1986 fiscal year. Thus, in most cases, the proposed findings and CST's brief describe CST's actual activities rather than proposed operations. The findings and brief generally speak in the present tense, even though the activities described evolved over several years.

(note 1) In the case of certain lengthy materials, CST's Appendix includes only those pages of particular exhibits pertinent to the proposed findings for which they are cited and additional pages necessary for context. CST's Appendix does not include those exhibits which are cited merely for the fact they are in the record and not for their content.

(note 2) See National Foundation, Inc. v. United States, 13 Cl. Ct. 486 (1987); Easter House v. United States, 12 Cl. Ct. 476 (1987); Church of the Visible Intelligence That Governs the Universe v. United States, 4 Cl. Ct. 55, 60 (1983).

## **I. CST's FORMATION AND ITS PURPOSE**

1. Church of Spiritual Technology (MCST") was organized under the California Nonprofit Religious Corporation Law on May 28, 1982 as a church of the Scientology religion. As provided by Article Three of its Articles of Incorporation, CST's purpose is to:

...espouse, present, propagate, practice, ensure, and maintain the purity and integrity of the religion of Scientology, as the same has been developed and may be further developed by L. Ron Hubbard to the end that any person wishing to, and participating in Scientology may derive the greatest, possible good of the spiritual awareness of his Beingness, Doingness and Knowingness. . . . More particularly, the corporation is formed for the accomplishment, without limitation, of the following more specific purposes:  
To serve as a means of promulgating, preserving and administering the religious faith of Scientology throughout the World.

(AR Ex. 1-3; AR pages 1-16 to I-17; CST App. 16-17).

Article Four of CST's Articles of Incorporation provides as follows:

In the conduct of its activities and the accomplishment of its purposes, the corporation shall have, shall enjoy, and may exercise, to their fullest extent, all powers which nonprofit corporations are permitted by law to have and to enjoy; PROVIDED HOWEVER, that:

- a. The property of the corporation is irrevocably dedicated to religious purposes, and no part of the income or assets of the corporation shall ever inure to the benefit of any private party or individual; and
- b. No substantial part of the activities of the corporation shall be devoted to attempts to influence legislation, by propaganda or otherwise, and the corporation shall not participate or intervene, directly or indirectly, in any political campaign on behalf of or in opposition to any candidate for public office; and
- c. The corporation shall not carry on any activities not permitted to be carried on by an organization exempt from federal income tax under Section 501(c)(3) of the Internal Revenue Code of 1954, or successor statutes of similar import; and
- d. The corporation shall not carry on any activities not permitted to be carried on by a corporation described in Section 170(c)(2), contributions to which are deductible under Section 170(a) of the Internal Revenue Code of 1954, or successor statutes of similar import.

(AR Ex. 1-3; AR page 1-18; CST App. 18).

CST's Bylaws state that CST has the "following general goals":

- a. Establishment of a religious body and entity to promote; protect, administer and encourage the religion of Scientology and its goals;
- b. Foundation, construction and use of a church, establishments, tutorial schools, retreats, parsonages, centers of training and other centers, for the teaching, dissemination and administration of the religion of Scientology, which aspires to the religious and ethical guidance and improvement of the individual character, and also to better and clarify the human spirit;
- c. Assistance in the foundation of Churches of Scientology and other organizations devoted to the religion of Scientology.
- d. Publication and distribution of religious literature and other sectarian aids in order to propagate and disseminate Scientology; and
- e. Establishment of religious cultural centers.
- f. Minister to the spiritual needs of the parishioners and congregants of the Church through the conduct of services, both group and individual.
- g. Establishment of a scholarship fund to provide assistance to those seeking advancement on the Scientology Bridge.
- h. Establishment and maintenance of a museum devoted to the religion of Scientology.
- i. Construction and maintenance of an imperishable structure, capable of withstanding the ravages of nuclear warfare to

house the essence of Scientology for the benefit of future generations.

j. Establishment and maintenance of a library devoted to the religion of Scientology.

(AR Ex. 1-4; AR pages 1-26 to 1-27; CST App. 26-27).

CST's specific religious objective "is to preserve and protect the [Scientology] religion so it can be practiced by all generations to come."

(AR Ex. 111-346; AR page 111-95; CST App. 563).

2. CST accomplishes its objective of preserving and protecting the Scriptures of the Scientology faith by making archival-quality copies of the original writings, tapes, films and other materials from which the Scriptures are derived, treating the original materials to preserve them against deterioration, and then storing the treated originals and the archival-quality copies in long-term archival repositories.

(AR Ex. III-346; AR pages 111-95, 111-144 to 111-157; CST App. 563, 612-625).

3. CST is unique among the Churches of Scientology. It operates independently of and is not part of the Scientology ecclesiastical hierarchy. It has never exercised any authority over any organization within the hierarchy and no organization has exercised any authority over it. It neither ministers Scientology services (other than to its own staff) nor provides any ecclesiastical management or support services.

(AR Ex. III-346; AR pages 111-101, 111-124, 111-142 to 111-143; CST App. 569, 592, 610-611).

## II. THE SCIENTOLOGY RELIGION AND ITS SCRIPTURES

4. The religion of Scientology evolved from the writings of L. Ron Hubbard, the founder of the religion and the sole author of its Scriptures. (AR Ex. 1-17; AR page I-100; CST App. 62; AR Ex. 111-346; AR page 111-96; CST App. 564). The religion of Scientology was fully formed by the time CST was incorporated, with voluminous Scriptures that express all the principal practices and fundamental beliefs of its adherents.

(AR Ex. II-7; AR page I-100; CST App. 62; AR Ex. 111-349; AR pages 111-252 to III-1102B).

5. The first church of Scientology was incorporated in 1954. Since then, the religion has grown to an international ecclesiastical hierarchy of hundreds of churches located throughout the United States and abroad. (AR Ex. 1-17; AR page I-100; CST App. 62; AR Ex. 11-76; AR page 11-134; CST App. 320). Individual churches within the ecclesiastical hierarchy minister religious services to Scientology parishioners, or provide ecclesiastical management and support services to other churches, or in the case of some churches, both.

(AR Ex. 11-76; AR pages 11-134 to 11-136, 11-140 to 11-141, 11-142 to 11-143, 11-146 to 11-149; CST App. 320-322, 326-327, 328-329, 332-335).

6. The basic tenet of Scientology is that man is an immortal spirit who has lived through previous lifetimes. Although he has a mind and a body, he is himself a spiritual being. The ultimate goal of Scientology is "a civilization without insanity, without criminals and without war, where the able can prosper and honest beings can have rights, and where Man is free to rise to greater heights." (AR Ex. 111-346; AR page 111-97; CST App. 565).

The principal sacrament in Scientology is "auditing," which consists of a gradient scale of religious services addressing the spirit. The purpose of auditing is to unburden man of past painful experiences and to orient him as a spiritual being. Auditing results in an increase in spiritual awareness and ability. Ultimately the person achieves certainty of himself as a spirit and freedom from unwanted burdens. At this point he also is certain of immortality.

(AR Ex. 111-346; AR pages 111-97 to 111-98; CST App. 565-566).

Churches of Scientology provide religious auditing services to their parishioners. They also conduct religious training both as seminary training for Scientology ministers and for spiritual enlightenment of parishioners. In training, the Scientologist studies the Scriptures of Scientology to the exclusion of all other materials.

(AR Ex. 111-346; AR page 111-98; CST App. 566).

A fundamental doctrine of the Scientology religion is that spiritual salvation can be attained by following the path Mr. Hubbard outlined in the Scriptures. This path starts with the applied religious philosophy expounded in Dianetics: The Modern Science of Mental Health, which Mr. Hubbard wrote in the early 1950s, and develops on through increasing levels of spiritual enlightenment contained in other texts written by Mr. Hubbard.

(AR Ex. 111-346; AR page 111-98; CST App. 566).

8. The portion of the Scientology Scriptures that constitutes the upper levels of spiritual awareness in the Scientology faith is called the religion's "Advanced Technology."

(AR Ex. 11-76; AR pages 11-247 to 11-248; CST App. 431-432; AR Ex. 111-346; AR page 111-98; CST App. 566).

9. A fundamental doctrine of the Scientology religion is that its religious services must be orthodox. Scientologists must receive religious services directly from and in the manner prescribed by the Scriptures or they will not attain salvation. Scientology churches assure parishioners that their religious services are orthodox by providing them under the imprimatur of certain marks associated with the religion. These Scientology religious marks include the terms "Dianetics," "Scientology" and Mr. Hubbard's name, initials and signature.

(AR Ex. 111-346; AR pages 111-99 to III-100; CST App. 567-568).

10. During his lifetime, Mr. Hubbard asserted full ownership over the Scientology Scriptural materials and religious properties he created, which he provided to the religion in various ways through the many years the religion has been practiced. He provided many Scriptural materials, such as his copyrighted books, directly to the public through formal written licensing agreements with publishing companies related to churches of Scientology. (AR Ex. 11-76; AR pages 11-187 to III-195; CST App. 373-381; AR Ex. 111-346; AR page 111-102; CST App. 570). The royalty rates and clauses in these licensing agreements were reasonable and consonant with industry practices and standards. (AR Ex. 11-76; AR page 11-458; CST App. 464).

11. During his lifetime, Mr. Hubbard provided religious instructional films directly to churches of Scientology by providing scripts which were used to produce the films.

(AR Ex. 11-76; AR page 11-196; CST App. 382).

12. During his lifetime, Mr. Hubbard permitted churches to use the Advanced Technology and religious marks through informal verbal agreements that he could terminate immediately for unorthodox practice. (AR Ex. 111-346; AR page 111-102; CST App. 570).

### III. L. RON HUBBARD'S BEQUESTS TO CST, RTC, AND CBI

13. In 1982 Mr. Hubbard began considering the future of orthodox Scientology religious practice after-his death. Mr. Hubbard wanted to give the Scientology Scriptures and religious materials to the religion itself, but he thought it more likely that orthodox practice would be compromised sometime in the future if he gave everything to one church. Mr. Hubbard concluded that the best way to ensure orthodoxy for all future years would be to divide rights to the Scriptures among separate churches serving specific religious functions. He believed one church should be responsible for maintaining orthodoxy by performing the exclusive function of supervising religious practice. He also believed that another church should serve as a "fail safe" mechanism to protect the Scriptures in the event they ever were threatened during the millions of years Scientology would be practiced. Mr. Hubbard decided to make his gift to the religion sequentially through three separate gifts.

(AR Ex. 111-346; AR pages 111-102 to 111-103; CST App. 570-571).

14. In May, 1982 Mr. Hubbard made the first gift by assigning substantial ownership of the religious marks and the right to use the Advanced Technology in the United States to Religious Technology Center ("RTC"), a California nonprofit religious corporation formed on January 1, 1982 for the exclusive purpose of ensuring orthodox practice of the Scientology faith. (AR Ex. 111-371; AR pages 111-1170 to 111-1180; CST App. 721-731; (Advanced Technology); AR Ex. 111-372; AR pages III-1181 to III-1229A; CST App. 732-781 (Marks)). Mr. Hubbard required, as a condition of the gifts, that RTC obtain recognition of its exempt status. If not, Mr. Hubbard had the power to appoint RTC's rights to another Scientology organization that already was recognized as exempt. (AR Ex. 111-371; AR pages 111-1173 to

111-1174; CST App. 724-725; AR Ex. 111-372; AR page 111-1187; CST App. 738). Mr. Hubbard also retained the nonexclusive right to certain secular uses of the marks, subject to RTC's approval. This reservation of rights did not include the right to use the Marks in connection with religious services. (AR Ex. 111-372; AR pages 111-1185 to 111-1186; CST App. 736-737).

(See also AR Ex. 111-346; AR pages 111-103 to 111-109; CST App. 571-577).

15. As required by Mr. Hubbard's gifts, RTC delegates rights to use the Advanced Technology and religious marks to qualified churches in the ecclesiastical hierarchy. RTC then supervises their activities to ensure compliance with Scriptural requirements. (AR Ex. 111-346; AR page 111-105; CST App. 573). Churches that minister the Advanced Technology to their parishioners provide RTC with six percent of the contributions they receive with respect to such services. (AR Ex. 111-346; AR page 111-108; CST App. 576). This funding is intended to support the religion of Scientology in general more than RTC's particular religious activities. (AR Ex. VII-591; CST App. 987). Pursuant to the terms of Mr. Hubbard's gifts, RTC must apply 90 percent of such funds it may receive to religious and charitable purposes that are either "within purposes of the religion of Scientology" or "for the general purpose of advancing the moral and ethical level of mankind." (AR Ex. 111-371; AR page 111-1174; CST App. 725).

(See also AR Ex. 111-346; AR pages 111-105 to 111-108; CST App. 573-576).

16. Church of Scientology International ("CSI"), a California nonprofit religious corporation, was formed in 1981 (AR Ex. 11-76; AR pages 11-143 to 11-144; CST App. 329-330) and is the ecclesiastical Mother Church of Scientology. As the Mother Church, CSI exercises ecclesiastical authority over all churches and missions of the religion that are part of the hierarchical church. (AR Ex. 11-76; AR page 11-147; CST App. 333).

RTC has granted CSI the license to use the marks in connection with services rendered by CSI pertaining to the Scientology religion. This grant extends to all of the organizations under the ecclesiastical authority of CSI that expressly agree and covenant to abide by the conditions of the grant to CSI and that recognize RTC as the protector of the religion. In return, CSI has agreed that RTC shall be the final authority with respect to decisions regarding protection of the religious marks. (AR Ex. II-76; AR page II-171; CST App. 357).

17. Mr. Hubbard made the second gift, also in May 1982, by giving CST the power to acquire RTC's rights to the Advanced Technology and religious marks if, and only if, any one of three narrowly-defined conditions occurs: (1) RTC fails to maintain the "ethical use" of the property 'in accordance with the Scientology Scriptures," (2) the property is ^in danger of appropriation by an entity outside of or hostile to the religion," or (3) RTC permits the property to be used in a way that both "is contrary to the Scientology Scriptures" and "seriously damages the religion of Scientology or the image or reputation of L. Ron Hubbard." (AR Ex. 1-21; AR pages 1-138 to 1-144; CST App. 65-71 (Marks); AR pages 1-191 to 1-196; CST App. 118-123

(Advanced Technology)). (See also AR Ex. 111-346; AR pages 111-109 to III-110; CST App. 577-578).

18. Mr. Hubbard granted the options to CST because CST was not subject to or part of the authority of the ecclesiastical hierarchy. Mr. Hubbard believed CST had to be independent of the hierarchical church with no responsibility for its actions to ensure that any decision it made with respect to the options would be objective. (AR Ex. 111-346; AR pages 111-104, 111-110;

CST App. 572, 578). Mr. Hubbard did not impose any obligation on CST to monitor use of the marks or the Advanced Technology or otherwise undertake any activity with respect to the options.

(AR Ex. 1-21; AR pages 1-138 to 1-144; CST App. 65-71 (Marks); AR pages I-191 to 1-196; CST App. 118-123 (Advanced Technology)).

19. Upon his death on January 24, 1986, Mr. Hubbard made the third gift by transferring to CST the bulk of his estate, including all of his copyrights to the Scriptures and his remaining rights in the marks and Advanced Technology, on the condition that CST obtains recognition of its tax-exempt status. This transfer was made through Mr. Hubbard's Last Will and Testament and through a revocable inter vivos trust. Mr. Hubbard transferred to his trust all property he owned, other than his intellectual properties and a few investment assets, which passed under his will. If CST does not obtain recognition of its exemption, Mr. Hubbard directed that his estate be distributed to one or more organizations described in Code section 501(c)(3) that operate exclusively for the purposes of the Scientology religion.

(AR Ex. 111-346; AR pages III-111 to 111-115; CST App. 579-583).

20. Mr. Hubbard's third gift included all his retained right over the Scientology marks and Advanced Technology, his patents concerning religious articles, and the copyrights to all of his Scriptural writings, as well as to his fictional works. The index of titles to his copyrights runs over 800 pages. A court-appointed referee appraised Mr. Hubbard's probate estate at \$26,305,706, almost all of which -- \$25,000,000 -- was attributable to Mr. Hubbard's intellectual properties. (AR Ex. 111-346; AR pages III-111 to 111-115; CST App. 579-583).

21. Mr. Hubbard's bequest to CST included the following copyrighted materials:

HCO Policy Letters -- Over 6,000 published issues concerning matters of ecclesiastical administration dating from 1957.

HCO Bulletins -- Over 4,000 published issues concerning the ministration of Scientology religious services dating from 1954.

Miscellaneous Issues -- Over 800 miscellaneous issues, directives and orders concerning various ecclesiastical matters dating from 1957, including Flag Orders, Central Bureau Orders, L. Ron Hubbard Executive Directives and Professional Auditor's Bulletins.

Compilations -- Over 120 volumes of compilations of issues, directives, bulletins, etc. concerning ecclesiastical matters and the ministration of religious services dating back to 1950, including Hubbard Communication Office ("HCO") Management Series, HCO Executive Course, HCO Technical Bulletins, HCO Office Board Policy, HCO Office Policy, HCO Office Bulletins and HCO Chronological Packs.

Lecture Tapes -- Over 3,000 tape recordings of lectures on the religion and on the ministration of religious services dating from 1950.

Films -- Over 110 instructional films on the Scientology religion and the ministration of Scientology religious services.

(AR Ex. 111-349; AR pages III-252 to III-11028).(note 3)

(note 3) Due to its volume, CST has not included Mr. Hubbard's estate inventory in its Appendix.

#### IV. CST'S ORGANIZATION AND STAFF

22. CST is an autonomous organization. It is governed by its own officers and staff. (AR Ex. 1-38; AR page 1-352; CST App. 161). It maintains its own books and records and its own bank accounts, and it disburses its funds only for purposes that have been approved in advance by its staff as accomplishing its religious program. (AR Ex. 1-17; AR page I-101; CST App. 63; AR Ex. III346; AR page 111-135; CST App. 603).

23. During the relevant periods, CST's staff has ranged from 15 to 63 highly-dedicated Scientologists-who work exclusively for CST. (AR Ex. 1-17; AR page 1-98; CST App. 60 (15 staff in mid-1984); AR Ex. 1-40; AR page 1-358; CST App. 167 (36 staff in late 1984); AR Ex. 111-346; AR page 111-125; CST App. 593 (55 staff in mid-1987); AR Ex. 11-76; AR page 11-184; CST App. 370 (63 staff in mid-1986)).

24. CST staff must be members of Scientology's religious order, the Sea Organization, which means they have signed a formal agreement committing themselves to the Scientology religion for the next billion years. (AR Ex. 111-346; AR page 111-125; CST App. 593; AR Ex. VII-588; CST App. 983).

25. CST staff are required to live free of the distractions of the secular world and stand ready to attend to their religious



duties at any time day or night. They eat communally in CST-provided dining rooms and live communally in CST-provided berthing.

(AR Ex. VII-756; CST App. 1197).

CST staff members generally work from 8:30 a.m. to 11:00 p.m. each day, with one day off every other week. (AR Ex. VII-684; CST App 1151).

26. CST maintains an extensive religious program for its staff. CST's ministers provide pastoral counseling, give spiritual advice, minister to the spiritual needs of CST's staff and perform sacerdotal functions such as namings, marriages and funerals. CST staff participate in religious observances six days each week where they receive the principal sacrament of Scientology, as well as training in the Scriptures. CST also has a formal program for the training and ordination of its ministers (AR Ex. 111-346; AR page 111-142 to 111-143; CST App. 610-611), although CST sends its ministers to other churches of Scientology for higher levels of ministerial training because CST does not have staff qualified to provide the needed training.

(AR Ex. VII-741; CST App. 1183; AR Ex. VII-754; CST App. 1184-1193).

27. CST requires all staff to devote two and one-half hours each day to the study of the Scientology Scriptures, technical materials related to their work, and ministerial training.

(AR Ex. VII-773; CST App. 1208).

28. CST's Bylaws require that its Trustees meet very rigid religious requirements to qualify both for election to the Board and for continued service on the Board. For example, candidates for election to the Board must

(1) have a good, uninterrupted record of at least eight years as an "ethical and loyal Scientologist,"

(2) have attained a specified high level of spiritual awareness,

(3) be "well versed in the technology of Dianetics and Scientology" and have "applied this technology to help others, with excellent results,"

(4) be "well versed in the administrative policy of organizations affiliated with the religion of Scientology" with "demonstrated success in the utilization and application of such policy,"

(5) be "an ordained Scientology minister, in good standing pursuant to those principles set forth in the Scriptures," and

(6) be "well versed in the Scientology Ethics and Justice System."

(AR Ex. 111-346; AR pages 111-117 to 111-118; CST App. 585-586).

CST's standards are more stringent for Trustees who wish to continue serving on the Board. As provided by its Bylaws, Trustees must, within ten years of appointment, achieve four specified levels of the highest religious-and ecclesiastical training. They also must spend a minimum of 12-1/2 hours each week receiving religious services or training toward attaining these four levels. (AR Ex. 111-346; AR page 111-118; CST App. 586).

Once Trustees satisfy the ten-year requirement, they must continue to meet very high religious standards. CST's Bylaws require that after their ten-year anniversary of service, Trustees must continue receiving or giving at least 12-1/2 hours of services or training each week.

(AR Ex. 111-346; AR pages 111-118 to 111-119; CST App.-586-587).

CST's General Directors also must meet high standards of religious accomplishment. As required by its Bylaws, each General Director must be a duly-ordained minister of Scientology in good standing with the Mother Church, well-versed in the Scriptures and the Scientology Ethics and Justice System, and a proven religious executive, as demonstrated by actual performance.

(AR Ex. 111-346; AR page 111-120; CST App. 588).

29. CST compensates its staff at a subsistence level, providing them with meals, berthing, child care, official Sea Organization uniforms, medical and dental assistance and other essentials, and a nominal weekly allowance of \$30 for personal items such as clothing, toiletries and cigarettes. Staff also may receive small bonuses each year based upon how well they performed their religious duties. (AR Ex. VII-756; CST App. 1197).

The average pay received by CST staff during the years in question was approximately \$3,800 per year (note 4)

For example, the four CST officers named below received compensation from CST as full time staff members during

fiscal year 1986. In addition to the reported cash compensation, these individuals (like other staff members) also received room, board and other essentials which were furnished to them by the organization. All the compensation paid was in their capacity as staff members, not as officers, directors or trustees:

Dan Przybylski	\$6,072
Nancy O' Meara	\$4,016
Russ Bellin	\$4,964
Leo Johnson	\$3,355
Total:	\$18, 407

(AR Ex. VII-581; CST App. 977).

(note 4) This approximate amount was determined by dividing the average yearly total staff compensation for fiscal years 1982 through 1986 (\$160,159.00 -- see CST PF 65) by the average size of CST's staff for the years in question (42 staff members -- see CST PF 21).

## V. CST'S ACTIVITIES

30. Since it was formed in 1982, CST has devoted all of its staff time and expenditures to providing religious services and training to its staff and to preserving the Scientology Scriptures. (AR Ex. III-346; AR page 111-140; CST App. 608).

31. CST's preservation activities have been substantial, ongoing and concern every medium in which the Scriptures exist -paper, tape and film. Since its mission is to ensure that the Scriptures will be available for all future generations, CST must be sure that the mediums on which the Scriptures are preserved will last millions of years. CST will accomplish its goal by using the most advanced techniques available to preserve the original materials (to the extent a technique exists) and by making multiple archival copies of the originals on different mediums that can be replaced with more durable materials as better preservation methods evolve. Multiple copies on different mediums give CST more flexibility in choosing copying processes in-the future and better ensure that at least one set of the Scriptures will be available in the event the originals and several sets of copies are somehow destroyed. (AR Ex. 111-346; AR pages 111-144 to 111-146; CST App. 612-614).

32. CST's administrative offices and main preservation facility are located on a 54-acre, 15-building compound located near San Bernardino, California that CST purchased for \$2.3 million in October 1985, approximately three years after it was formed. (AR Ex. VII-594; CST App. 1123; AR Ex. VII-819; CST App. 1236-1254).

33. CST's offices and main preservation facility were in major disrepair when CST purchased it, and over the next eighteen months CST devoted more than \$400,000 and a considerable amount of staff time to renovating some of the buildings and improving the property. (AR Ex. VII-573; CST App. 923; AR Ex. VII-594; CST App. 1123)

34. CST uses every structurally-sound building to further its preservation program, although several of the buildings are uninhabitable and require major renovations. It uses eight buildings for staff housing and dining, one as a workshop and another as a gate-house. (AR Ex. VII-594; CST App. 1123).

CST conducts its preservation and archival activities and temporarily stores the original Scriptures in its 6,000 square-foot preservation building. (AR Ex. VII-722; CST App. 1164-1165).

CST extensively renovated this building to protect the original Scriptural materials from fire, pollutants and other elements. (AR Ex. 111-352; AR pages 111-1126 to 111-1127; CST App. 696697).

35. CST installed multiple layers of sheet rock in the ceiling and floor of its preservation building to give them a two-hour fire rating and it installed fire-rated doors as well as temperature and humidity controls and air cleaners. (AR Ex. 111-352; AR page 111-1127; CST App. 697).

36. Since it was formed, CST has devoted most of its preservation activities to the written Scientology Scriptures.

The original manuscripts of the Scientology Scriptures are very extensive -- they include over 500,000 pages of separate "issues" or pronouncements on the ministration of religious services and ecclesiastical administrative matters and 297 books, 261 pamphlets, essays, and summaries, 855 magazines, 355 course compilations, and 142 reference compilations on Dianetics and Scientology. In addition to original, handwritten versions of the issues, CST has the official "mimeo" or published versions of the issues.

(AR Ex. 111-346; AR pages 111-115, 111-145 to III147; CST App. 583, 613-615).

37. As a necessary first step in the preservation process for written materials, CST must locate and collect the original version of each writing. CST collects these originals from Scientologists and Scientology churches located throughout the world. (AR Ex. 111-346; AR page 111-145; CST App. 613). CST's collection activities have been extensive. Its first collection trip was to the Church of Scientology in Washington, D.C. in 1985. (AR Ex. V-534; AR page V-35; CST App. 819). Since then, CST has sent staff on collection missions to Canada, England, Denmark, Australia, Germany and Switzerland and throughout the United States. (AR Ex. 111-346; AR page 111-145; CST App. 613). From mid-1985 through mid-1987, CST spent more than \$220,000 for travel. (AR Ex. VII-580; CST App. 951; AR Ex. VII-581; CST App. 962).

With one minor exception, all original writings CST has collected have been provided to it as gifts in recognition of the contribution to society of CST's preservation program. (AR Ex. V-534; AR page V-35; CST App. 819). The sole exception to these gratuitous gifts occurred in late 1985 when CST learned that a Scientologist living in England possessed a number of early Professional Auditor Bulletins and early technical bulletins, many fully or partially handwritten by Mr. Hubbard. On this parishioner's death, his wife contributed these valuable originals of the Scriptures to CST. In exchange, his wife was awarded some religious services at the Church of Scientology in London, her home. (AR Ex. V-534; AR page V-36; CST App. 820).

38. As writings are located and collected, they are delivered to CST's archival facilities and sorted, categorized and filed temporarily in environmentally-controlled facilities. The writings then undergo copying and preservation processes. (AR Ex. 111-346; AR page 111-146; CST App. 614).

39. Before preserving the original writings, CST makes seven copies of each original. It makes two copies on a microfilm that has a life span of at least 100 years and five copies on an acid-free paper and ink with a 1,000-year life span, called "Durable Masters." CST anticipates this duplication stage will take a long time. It already has taken CST staff two years to microfilm the original issues, which consist of 500,000 pages, and CST estimates that it will take several years to reproduce an entire set of the original written issues on Durable Masters. CST has yet to reproduce the articles, books, transcripts, notes and other writings that make up the written Scriptures. (AR Ex. 111-346; AR pages 111-146 to 111-148; CST App. 614-616).

40. After CST reproduces the written Scriptures, it will preserve the paper itself by putting it through a deacidification process to prevent deterioration from the acid contained in the paper. CST then will encapsulate the deacidified paper in clear, archival mylar plastic envelopes that have a life span in excess of 1,000 years. (AR Ex. 111-346; AR pages 111-148 to 111-149; CST App. 616-617).

41. As the final step in the paper preservation process, CST will place the encapsulated originals in gas-filled time capsules similar to those used by the National Archives for preserving the Constitution and the Declaration of Independence, which CST then will store in a special long-term storage facility designed just for the originals. (See CST PF 52, 56). CST also will place sets of the Durable Masters and microfilm copies in fire-proof, gas-filled containers and store them in its other archival facilities. Other sets will be available as sources for current research. (AR Ex. 111-346; AR pages 111-149 to 111-150; CST App. 617-618).

42. The Scriptures of the Scientology religion include over 42 films of lectures Mr. Hubbard gave on Dianetics and Scientology in the late 1950s and early 1960s and instructional films on the technology of the religion that were written

or directed by Mr. Hubbard. CST plans to maintain a complete set of the original films in its archives and store a complete set of duplicates in each of the three vault repositories it will construct. At present, CST is storing the originals of the films in special environmentally-controlled storage facilities at CST's studio for production of religious films. (AR Ex. 111-346; AR page 111-150; CST App. 618).

43. CSI has completely refurbished many original scriptural films that were produced in the mid-1960s and that had become faded and scratched through extensive use over the years. CSI also produced a limited number of the films, and CST acquired four sets of them to preserve in its storage vaults. (AR Ex. VII-864; CST App. 1257).

44. To date CST only has collected original Scriptural film. It has yet to begin reproduction and preservation, although after extensive research, it has concluded that the best method for preserving original film will be through a color separation process.

(AR Ex. 111-346; AR page 111-150; CST App. 618).

This process requires expensive equipment to separate the colors and screen them out of the film, leaving it black and white, a state in which it can be stored for a much longer time than color film. (AR Ex. 11-76; AR page 11-234; CST App. 419).

45. CST has found that existing laboratories cannot perform this color separation process at the high quality standards desired and that their work in any event would cost over \$1 million. CST may purchase the necessary equipment and process the film on its own, although current estimates are so expensive -- \$350,000 for the equipment and approximately \$150,000 to process each set of film -- that CST is still in the planning stage.

(AR Ex. 111-346; AR pages 111-150 to 111-151; CST App. 618-619).

46. CST constantly monitors the industry for new developments in film preservation. It is particularly interested in preservation techniques that record film images in digital format for storage on laser discs. While existing equipment can do this, CST is not satisfied with the resolution of the finished product. This technology is still evolving, however, and CST expects that better quality discs may be available soon and that it eventually will be able to use this process. (AR Ex. 111-346; AR page 111-151; CST App. 619).

47. A very important source of Scientology scriptures are the recordings of Mr. Hubbard's lectures on Scientology and Dianetics, which date back to as early as 1946. CST has over 6,500 master reels of original recordings of Mr. Hubbard's lectures, including over 900 small plastic disc recordings of lectures Mr. Hubbard gave between 1946 and 1950 called "Soundscriber discs." (AR Ex. 111-346; AR page 111-151; CST App. 619).

48. CST already has made seven complete sets of each master lecture and Soundscriber discs on magnetic tape. This project took ten CST personnel over two years to complete and has cost over \$1.3 million in tape and studio equipment. In all, CST has made four archival quality copies on reel-to-reel magnetic tape that it will store in its archival facilities and two copies on cassette tape that it will use for research purposes. It also has made a non-archival quality tape that it will provide to CSI. CSI will use this tape to transcribe Mr. Hubbard's master recordings into 100 two to three-inch thick volumes. In exchange for this tape, CSI will provide CST with one set of the 100 volume transcription which CST can preserve. (AR Ex. 111-346; AR pages 111-151 to 111-152; CST App. 619-620; AR Ex. 111-352; AR page III-1135C; CST App. 708).

49. CST is not satisfied with the life of magnetic tape and has been researching mediums that have a longer life. This research has led to digital sound technology, which CST believes holds great promise for the future. Digital sound technology has the added benefit of enabling CST to reconstruct audio information that is lost when the oxide covering wears off from very old, frail tapes. At present, CST is setting up a digital production line to convert the analog signals on magnetic tape to digital signals, which CST will record on special archival quality videotape. CST plans to record all 6,500 master reels special archival-quality video tape. CST estimates that this project will cost \$200,000. (AR Ex.

111-346; AR pages 111-152

on to 111-153; CST App. 620-621; AR Ex. 111-352; AR page III-1135G; CST App. 712).

50. Since video tape has about the same life as magnetic tape, CST plans eventually to store the digital version of Mr. Hubbard's lectures on a longer lasting medium, such as laser discs. However, currently available mass-produced laser

discs (which consist of aluminum plated plastic) have an even shorter life span than magnetic tape, so CST has been exploring special, archival laser discs made of more durable materials. In initial stages of its research, CST made a prototype disc of chrome plated glass for \$1,800 but found the medium unworkable. Subsequently, it concluded that discs made of gold plated glass may prove to be the best medium for long-term storage, but current production costs are too high -- it would cost approximately \$6.5 million to record one set of the master reels on these laser discs. Until costs are reduced, or a more practical medium is found, CST will continue to make digital versions of the recording on video cassette tape. (AR Ex. III346; AR pages 111-152 to 111-153; CST App. 620-621; AR Ex. III352; AR pages III-1135H to 111-1135I; CST App. 713-714).

51. In addition to preserving the actual media containing the written and spoken words of Scientology Scriptures, CST must house both the originals and the archival copies of the Scriptures in a way to ensure that they will be available for millions of years. In light of the limitations of current technology, CST has decided that its vaults must have a minimum life of 1,000 years. To meet these specifications, CST has thoroughly researched such matters as vault design, specifications, engineering, tunneling methods, materials and doors. It also spent one year inspecting numerous potential sites and investigated the effects of local geology as well as the potential effects of earthquakes, floods and nuclear war. (AR Ex. 111-346; AR page 111-154; CST App. 622; AR Ex. 111-352; AR page III-1135J; CST App. 715).

52. For the present, CST plans to store the archival copies in three long-term vault repositories that it will construct. (AR Ex. 111-346; AR page 111-154; CST App. 622). CST already has purchased sites for two repositories for its-archival copies, a 3,520-acre tract in New Mexico, which it purchased in 1984 for \$250,976, (AR Ex. VII-804; CST App. 1228; AR Ex. VII-805; CST App. 1229-1235), and two tracts of land in Northern California totaling approximately 3,000 acres, (AR Ex. VII-594; CST App. 1127), which it purchased in 1983 for \$1,500,000. (AR Ex. VII798; CST App. 1218-1222; AR Ex. VII-799; CST App. 1223; AR Ex. VII-800; CST App. 1224-1227). CST has not yet purchased property for its third repository, which it plans to locate outside the United States. It also will store the originals of the Scripture in a special repository it will construct at its main preservation facility in San Bernardino, California. (AR Ex. 111-346; AR pages 111-154 to 111-156; CST App. 622-624).

53. CST began work on the New Mexico project late in the summer of 1985 and retained a general contractor to construct the vault in October 1985. (AR Ex. VII-648; CST App. 1133-1141). CST then spent about a year researching proper design of the vault. Before beginning work, CST had to provide for basic necessities such as access, living quarters, water, etc. CST also had to prepare the vault itself before it could begin drilling by reinforcing the facing of the site (\$65,000), building a work pad (\$130,000) and installing a hoist (\$65,000). (AR Ex. 111-352; AR pages III-1135J to III-1135M; CST App. 715718).

54. CST had to alter its initial design once construction actually began as a result of unknown defects in the vault sites. In the first 50 feet of drilling, CST encountered four major rock fissures, each of which required \$90,000 and weeks of work to fix. When exploratory drilling showed six more fissures in the next 200 feet, CST decided to redesign the vault to avoid them. As redesigned, the New Mexico vault totals 500 feet, consisting of a 200-foot entrance tunnel that will fork into two separate storage tunnels, each 150 feet in length. The tunnel has a three to four-inch thick concrete lining and a drainage system patterned on systems used in Swiss railway tunnels. The vault will have four doors with a maintenance-free life of 1,000 years. Two of the doors will be nuclear blast resistant and constructed out of stainless steel, corrosion-resistant steel and concrete and will weigh approximately 6,500 pounds each. They will cost \$120,000. CST estimates that the total cost of this one vault will exceed \$2 million. (AR Ex. 111-346; AR page 111-155; CST App. 623; AR Ex. 111-352; AR pages III-1135N to 111-1135O; CST App. 719-720).

55. CST currently is in the planning stage with respect to the other long-term vaults it will construct, though it expected to begin site preparation and initial construction for the second vault in early 1988. CST projects the cost to construct the other two vaults (and to purchase the final site) at over \$5 million. Construction of living facilities will cost another \$50,000 to \$100,000 per site. (AR Ex. 111-346; AR page 111-156; CST App. 624).

56. CST plans to construct a separate underground storage facility at its preservation facility in San Bernardino to house the original scriptural materials. This vault will be similar to the long-term vault repositories but will have more extensive environmental controls and other special features such as air conditioning, humidity controls and a halon gas fire extinguishing system in light of the fragile condition of the originals. CST estimates this vault will cost approximately \$750,000 to construct. (AR Ex. 111-346; AR pages 111-156 to 111-157; CST App. 624-625).

57. CST often must carry out its own research program to develop the equipment and techniques necessary to meet its demanding specifications. CST's research staff are highly trained and experienced technical experts capable of researching the most advanced methods in preservation technology. CST's research personnel work closely with archival professionals, chemists and engineers and leading manufacturers of state-of-the art products. They keep abreast of technological advances by attending trade shows and conferences and by reviewing reports of new developments by organizations such as the Library of Congress Preservation Office, the National Archives, the National Bureau of Standards, and the American National Standards Institutes. (AR Ex. 111-346; AR page 111-157; CST App. 625).

58. The work of CST's research personnel is ongoing and includes research concerning the following:

1. Microfilm. CST conducted extensive research on archival micro-filming techniques and equipment for reproducing the original written scriptures.
2. Color Separation. CST has conducted substantial research concerning color separation as a preservation process for the original film tape.
3. Durable Paper and Ink. CST researched and explored with major manufacturers the longest-lasting archival paper and ink to use for copying the Scriptures on Durable Masters.
4. Digital Audio. CST spent approximately two years researching digital recording to determine if it could be used to record the Scripture's lectures in accordance with CST's archival standards.
5. Laser Discs. CST also has researched archival laser discs as a method to preserve scriptural film and tape, including gold and glass archival laser discs.
6. Respooling. CST conducted research concerning special respooling equipment and techniques to preserve magnetic recording tapes.
7. Soundsciber Discs. CST conducted research on special techniques to preserve copies of discs.
8. Environmental Conditions. CST conducted extensive research concerning the ideal storage conditions for every type of material to be archived, both originals and copies, including proper temperature and humidity controls, air and ultra-violet filters, fireproofing, sealing materials and security devices.
9. Archival Xerography. After extensive research, CST concluded that xerography could be a viable archival process if used with the archival paper and ink it developed to produce Durable Masters.
10. Binding. CST has researched and developed an archivally-certified binding method to bind the packs of Durable Masters it is creating for issues and for books.
11. Deacidification. CST is researching various methods to neutralize the acid content of paper and deposit an alkaline buffer that prevents future environmental contamination. CST will use this process to preserve all written originals.
12. Encapsulation. CST is researching archival mylar plastics and plans to preserve all original written materials by encapsulating them through this sealing process.
13. Time Capsules. CST is researching airtight containers filled with inert gas to house the original materials for storage.
14. Vault Construction. CST personnel spent a year actively researching vault structures best suited for housing the Scriptures, both originals and copies, including the most durable materials for vault construction, tunneling methods and vault design. CST also surveyed different sites to determine the best geological location for the vaults.
15. Vault Doors. CST conducted extensive research to identify doors and manufacturers of doors capable of resisting

natural and man-made disasters while also remaining maintenance free for over 1,000 years.

16. E-Meter Research. CST has engaged in research along with an outside research firm, Action Enterprises, to develop an E-Meter (a religious artifact used in delivering Scientology religious services to parishioners) that can be used by highly aware spirits who are exterior to bodies.

(AR Ex. VII-604; CST App. 1129-1130). This research will assist spirits to attain total spiritual freedom by ensuring that Scientology's technology is available through the most advanced procedures.

(AR Ex. 111-346; AR pages 111-157 to 111-161; CST App. 625-629).

CST research personnel also have developed and/or implemented certain new techniques and devices related to its preservation functions. Some of these new developments in the field of sound recording include: development of speed analyzer equipment; engineering of a special tone generator; a special grounding bar; and development of a micrometer adjustable playback head. (AR Ex. 111-346; AR page 111-161; CST App. 629).

## VI. CST'S FINANCES

59. Through 1986 CST funded its activities primarily with voluntary grants from other churches of Scientology and from its investment income. (AR Ex. 111-346; AR pages 111-135 to 111-136; CST App. 603-604). To preserve its independence from the ecclesiastical hierarchy, CST was not willing to accept contributions with restrictions beyond those resulting from its Articles of Incorporation, Bylaws, and religious doctrines. (AR Ex. 1-29; AR page I-229; CST App. 147). Article Four of CST's Articles of Incorporation provides:

a. The property of the corporation is irrevocably dedicated to religious purposes, and no part of the income or assets of the corporation shall ever inure to the benefit of any private party of individual; (section b is omitted)

C. The corporation shall not carry on any activities not permitted to be carried on by an organization exempt from federal income tax under Section 501(c)(3) of the Internal Revenue Code of 1954, or successor statutes of similar import.

(AR Ex. 1-3; AR page 1-18; CST App. 18).

60. In 1983 CST received a one-time start-up grant of \$17,959,745.00 from Church of Scientology Flag Service Organization ("CSFSO"). CST provided nothing to CSFSO in exchange for this grant. (AR Ex. 111-346; AR pages 111-135 to 111-136; CST App. 603-604; AR Ex. VII-578; CST App. 924-934). CSFSO is a Florida nonprofit religious corporation that is situated in Clearwater, Florida. Its parishioners are Scientologists from foreign countries and the United States and staff members from other churches who travel to CSFSO to take the highest levels of auditing and training in the Scientology Advanced Technology. (AR Ex. 11-76; AR page 11-168; CST App. 354).

61. CST has received unrestricted grants from RTC as follows:

Fiscal Year	-Grant
1982	\$ 623,137.00
1983	1,905,125.00
1984	1,282,113.00
1985	2,029,949.00
1986	2,792,211.00
TOTAL	\$ 8,632,535.00

(AR Ex. 1-2; AR page 1-6; CST App. 5; AR Ex. 1-17; AR page I-100; CST App. 62 (1982); AR Ex. VII-578; CST App. 924-934 (1983); AR Ex. VII-579; CST App. 935-949 (1984); AR Ex. VII-580; CST App. 950-960 (1985); AR Ex. VII-581; CST App. 961-979 (1986)). These grants bear no relationship to the few instances in which CST provided copies of Scriptural materials to CSI or RTC. (Entire Record).

62. RTC provided CST these grants pursuant to the terms of Mr. Hubbard's gift of the Advanced Technology, which requires RTC to apply 90 percent of the funds it receives with respect to the use of the Advanced Technology to religious and charitable purposes. (AR Ex. 111-346; AR page 111-108; CST App. 576). Since one purpose suggested in Mr. Hubbard's gift is

"establishing and maintaining an indestructible record of the Scientology Scriptures" (AR Ex. 111-371; AR page 111-1174; CST App. 725), RTC elected to grant the 90 percent amounts to CST in those years. CST anticipates that RTC may reduce its level of funding once CST receives Mr. Hubbard's estate. (AR Ex. 111-346; AR page 111-136; CST App. 604).

63. CST has funded a portion of its program with interest earned from its bank accounts:

Fiscal Year	Interest Earned
1983	\$ 812,954.15
1984	1,677,560.00
1985	1,320,655.00
1986	<u>1,035,112.00</u>
Total	4,846,281.15

(AR Ex. VII-578; CST App. 924 (1983); AR Ex. VII-579; CST App. 935 (1984); AR Ex. VII-580; CST App. 950 (1985); AR Ex. VII-581; CST App. 961 (1986)).

64. CST has a few other small sources of financial support in addition to its grant and interest income. It has received rent from one property on which it plans to construct a storage vault in the future:

Fiscal Year	Rental Income
1983	\$12,500.00
1984	15,000.00
1985	15,000.00
1986	<u>17,500.00</u>
Total	60,000.00

CST has realized gains from currency exchanges:

Fiscal Year	Exchange Gain Income
1985	\$ 262,580.00
1986	<u>129,023.00</u>
TOTAL	\$ 391,603.00

CST has realized income from the occasional sales of assets such as automobiles and timber:

Fiscal Year	Income
1985	\$ 2,705.00 (timber)
1986	<u>1,750.00</u> (automobiles)
TOTAL	\$ 4,455.00

CST has received occasional small payments from other churches of Scientology for Field Staff Member ("FSM") commissions: (note 5)

(note 5) FSMs generally are independent Scientology ministers who receive commissions for their fundraising activities on behalf of (footnote continued)



Fiscal Year	Income
1984	\$ 1,925.00
1985	705.00
1986	<u>1,660.00</u>
TOTAL	\$ 4,290.00

CST has received reimbursement for the cost of duplicating Scriptural material:

Fiscal Year	Reimbursement
1984	\$ 23,149.00
1985	4,525.00
1986	<u>9,113.00</u>
TOTAL	\$ 36,787.00

(AR Ex. VII-578; CST App. 924-934 (1983); AR Ex. VII-579; CST App. 935-949 (1984); AR Ex. VII-580; CST App. 950-960 (1985); AR Ex. VII-581; CST App. 961-979 (1986)).  
(footnote continued from previous page)

a particular Scientology organization delivering religious services to the public. (AR Ex. 11-76; AR pages 11-392 to II-397; CST App. 442-447). Church staff sometimes perform FSM services, and when they do, the fund raising commissions are paid to the church for which the staff member works. (AR Ex. 11-76; AR pages 11-392 to 111-396; CST App. 442-446).

CST has never had FSMs. (AR Ex. 11-76; AR page 11-392; CST App. 442).

65. During the years in issue, CST incurred the following operating expenditures:

#### Employee Compensation

1982	9,608
1983	46,896
1984	147,231
1985	268,751
1986	328,309
Total	800,795

#### Professional Fees

1982	16,431
1983	69,476
1984	145,714
1985	508,249
1986	798,179
Total	1,538,049

#### Supplies

1982	3,378
1983	6,997
1984	450,665
1985	356,648
1986	136,646
Total	954,334

#### Telephone

1982	333
1983	6,793
1984	26,383
1985	50,755
1986	95,480
Total	179,744

Postage

1982	0
1983	705
1984	4,564
1985	19,329
1986	20,588
Total	45,186

Occupancy

1982	0
1983	23,024
1984	121,432
1985	198,255
1986	177,470
Total	520,181

Equipment/Costs

1982	440
1983	31,418
1984	29,863
1985	148,776
1986	84,286
Total	294,783

Publications

1982	0
1983	0
1984	12,672
1985	20,370
1986	12,053
Total	45,095

Travel

1982	7,394
1983	41,124
1984	85,801
1985	87,074
1986	135,476
Total	356,869

Interest

1982	0
1983	9,594
1984	13,272
1985	0
1986	0
Total	22,866

#### Staff Training

1982	0
1983	0
1984	13,674
1985	15,550
1986	14,604
Total	43,828

#### Membership & Dues

1982	0
1983	0
1984	23,300
1985	11,000
1986	14,670
Total	48,970

#### Charitable Donations

1982	0
1983	0
1984	250,000
1985	375,000
1986	0
Total	625,000

#### Books & Films

1982	0
1983	22,216
1984	43,601
1985	11,360
1986	30,072
Total	107,249

#### Miscellaneous

1982	0
1983	278
1984	291
1985	221
1986	1,584
Total	2,374

#### Total Operating Expenditures:

1982	\$37,584
1983	258,521
1984	1,368,463
1985	2,071,338
1986	1,849,417
Total	5,585,323

(AR Ex. 1-2; AR pages 1-2 to 1-14; CST App. 1-14 (1982); AR Ex. VII578; CST App. 924-934 (1983); AR Ex. VII-579; CST App. 935-949 (1984); AR Ex. VII-580; CST App. 950-960 (1985); AR Ex. VII-581; CST App. 961979 (1986)).

#### Capital Expenditures

##### Land

1982	0
1983	3,376,431
1984	0
1985	865,000
1986	0
Total	4,241,431

#### Building

1982	0
1983	134,089
1984	76,913
1985	1,993,140
1986	1,614,973
Total	3,819,115

#### Plant & Technology

1982	39,284
1983	56,490
1984	313,966
1985	130,145
1986	173,759
Total	714,184

#### Furniture

1982	0
1983	1,188
1984	14,753
1985	39,648
1986	43,620
Total	99,209

#### Vehicles

1982	34,913
1983	378
1984	34,668
1985	66,922
1986	21,299
Total	158,180

#### Office

1982	0
1983	11,314
1984	5,974
1985	44,375
1986	48,068
Total	109,731

#### Total Capital Expenditures

1982	\$74,737
1983	\$3,579,890
1984	446,274
1985	3,139,230
1986	1,901,719
Total	9,141,842

(AR Ex. 1-2; AR pages 1-2 to 1-14; CST App. 1-14; AR Ex. VII-578; CST App. 924-934; AR Ex. VII-579; CST App. 935-949; AR Ex. VII-580; CST App. 950-960; AR Ex. VII-581; CST App. 961-979).

For all the years in issue, CST incurred a total of \$14,727,165 in capital and operating expenditures. (AR Ex. 1-2; AR pages 1-2 to 1-14; CST App. 1-14 (1982); AR Ex. VII-578; CST App. 924-934 (1983); AR Ex. VII-579; CST App. 935-949 (1984); AR Ex. VII-580; CST App. 950-960 (1985); AR Ex. VII-581; CST App. 961-979 (1986)).

67. CST devotes fully 100 percent of its budget either in support of or directly to its preservation program, or to the ministrations of religious services to its staff. (AR Ex. III346; AR page 111-140; CST App. 608).

Operating Expenditures	Percent of Total Expenditures
Employee Compensation	5
Professional Fees	10
Supplies	6
Telephone	1
Postage	0.5
Occupancy	4
Equipment Cost	2
Publications	0.5
Travel	2
Interest	0
Staff Training	0.5
Membership Dues	0.5
Charitable Donations	4
Books/Films	1
Miscellaneous	<u>0</u>
Total	37%

Capital Expenditures	Percent of Total Expenditures
Land	29
Building	26
Plant/Technology	5
Furniture	1
Vehicles	1
Office	<u>1</u>
Total	63%

(AR Ex. 1-2; AR pages 1-2 to 1-14; CST App. 1-14 (1982); AR Ex. VII-578; CST App. 924-934 (1983); AR Ex. VII-579; CST App. 935-949 (1984); AR Ex. VII-580; CST App. 950-960 (1985); AR Ex. VII-581; CST App. 961-979 (1986)).

68. By the end of its 1986 fiscal year, CST had spent nearly \$1.7 million on its New Mexico archival repository. (AR Ex. VII-573; CST App. 922).

69. CST estimates it will have to spend from \$16 to \$36 million to complete various current and planned projects, as follows:

Project	Budgeted	Reference
<u>Written Works:</u>		
(1) Gold and/or glass laser Disc storage	\$2,000,000	(AR Ex. 111-346; AR page 111-147; CST App. 615).

- |                                 |             |  |
|---------------------------------|-------------|--|
| (2) Durable masters – five sets | \$ 500,000  | (AR Ex. 111-346; AR page 111-148; CST App. 616). |
| (3) Time capsules               | \$1,500,000 | (AR Ex. 111-346; AR page 111-149; CST App. 617). |
| (4) Deacidification equipment   | \$ 300,000  | (AR Ex. 111-346; AR page 111-149; CST App. 617). |

Films:

- |                                |            |  |
|--------------------------------|------------|--|
| (5) Color separation equipment | \$ 350,000 | (AR Ex. 111-346; AR page 111-518; CST App. 619). |
| (6) Color separation process   | \$ 600,000 | Id.  |

Audio Tapes:

- |   |                         |   |
|---|-------------------------|---|
| (7) Laser Discs                               | 5 million to 25 million | (AR Ex. 11-76; AR pages 111-233 to 11-234; CST App 418-419) |
| (8) Equipment and tapes for Digital recording | \$ 390,000              | Id.   |

Vaults:

- |   |                              |             |
|---|------------------------------|-------------|
| (9) Two storage vaults For boxes and third site | \$5,000,000                  | (CST PF 55) |
| (10) Living Quarters at Third Site:             | \$ 200,000                   | (CST PF 55) |
| (11) Vault for Originals                        | \$ 750,000                   | (CST PF 56) |
| TOTAL   | \$16,590,000 to \$36,590,000 |             |

70. As of April 30, 1987, the end of CST's fiscal year 1986, CST's net worth was \$25,707,056. (AR Ex. VII-581; CST App. 963).

## VII. CST's RELATIONSHIP WITH L. RON HUBBARD AND THE HIERARCHICAL CHURCH

71. CST operates as an independent organization. It is operated and controlled by its own officers, directors and staff members, and only its own officers, directors and staff members. All decisions as to what materials to preserve are made only by CST's staff, officers or directors. No other organization makes these decisions. (AR Ex. 1-17; AR page 1-98; CST App. 60).

72. CST's relationship with L. Ron Hubbard was a religious one -- Mr. Hubbard founded and developed the religion for which CST was organized and exclusively operate. (AR Ex. 111-346; AR pages 111-95 to 111-96; CST App. 563-564). CST had no legal connection with Mr. Hubbard other than serving as the intended beneficiary of his estate and the recipient of his gift of the options to the Scientology marks and Advanced Technology. Mr. Hubbard was never an officer, director, or trustee of CST (AR Ex. 1-2; AR pages 1-2 to 1-14; CST App. 1-14; AR Ex. VII-578; CST App. 924-934; AR Ex. VII-579; CST App. 935-949; AR Ex. VII-580; CST App. 950-960; AR Ex. VII-581; CST App. 961-979) and was never a party to any contract with CST. (Entire Record)

73. Mr. Hubbard never had any position of authority with respect to CST and he never had or exercised any control

over CST.

(AR Ex. 1-46; AR page 1-393; CST App. 187; AR Ex. 1-69; AR page 1-723; CST App. 233).

74. Author Services, Inc., Mr. Hubbard's literary and financial agent, has never exercised any control over CST.

(AR Ex. 1-46; AR page 1-392; CST App. 186; AR Ex. V-534; AR page V-25; CST App. 809).

75. CST never made copies of Scriptural materials it collected available to Mr. Hubbard during his life; Mr. Hubbard was not even aware that CST was collecting them. CST never provided any copies of Scriptural materials to Author Services, Inc. (AR Ex. V-534; AR pages V-36 to V-37; CST App. 820-821).

76. CST never made or participated in any payment to Mr. Hubbard.

(AR Ex. 1-2; AR-pages 1-2 to 1-14; CST App. 1-14 (1982); AR Ex. 1-38; AR page 1-355; CST App. 164; AR Ex. VII-578; CST App. 924-934 (1983); AR Ex. VII-579; CST App. 935-949 (1984); AR Ex. VII-580; CST App. 950-960 (1985); AR Ex. VII-581; CST App. 961-979 (1986); Entire Record).

77. CST is unique among the Churches of Scientology. CST operates independently of the hierarchical church of Scientology. CST is not controlled by the hierarchical church or any of its officials and does not control it or any of its officials.

(AR Ex. 1-46; AR page 1-393; CST App. 187).

Neither CSI, RTC nor any other organization within the hierarchical church has or has ever sought to exercise any authority or control over CST, and CST never has had or has sought to exercise any authority or control over CSI, RTC or any other organization within the ecclesiastical hierarchy.

(AR Ex. I-52r AR pages 1-438 to 1-441; CST App. 199202; AR Ex. 1-53; AR pages 1-442 to 1-444; CST App. 203-205; AR Ex. 1-54; AR pages I-445 to 1-447; CST App. 206-208).

It neither ministers scientology services (other than to its own staff) nor provides any ecclesiastical management or support services.

(AR Ex. 111-346; AR pages 111-101, 111-124, 111-142 to 111-143; CST App. 569, 592, 610-611).

78. CST maintains its own financial books and records and its own bank accounts. It does not participate in the financial network of the hierarchical church, nor does it participate in hierarchical church's system-of centralized reserves. (AR Ex. 111-346; AR page 111-135; CST App. 603). It does not use SOR Management Services Ltd. ("SORMS") (see CST PF 124 for a description of SORMS) as a banking agent for its reserves. (AR Ex. 111-346; AR page 111-138; CST App. 606).

CST's own personnel manage and control its bank accounts.

(AR Ex. 1-46; AR page 1-390; CST App. 184).

CST's Treasury Division is responsible for performing all bookkeeping and general financial functions. It operates under the direction of CST's Finance Officer, who is a member of CST's Executive Council. (AR Ex. 111-346; AR page 111-135; CST App. 603).

CST's Executive Council is responsible for making high-level managerial decisions and for approving proposed activities and budgets and is composed of CST's Commanding Officer, CST's four Deputy Commanding Officers, and CST's Finance Officer.

(AR Ex. 111-346; AR pages 111-124 to 111-125; CST App. 592-593).

CST's reserves are managed by the Executive Council in consultation with CST's President. The signatories on CST's bank accounts are its officers.

(AR Ex. 111-346; AR page 111-138; CST App. 606).

CST staff control all of CST's investment policies, subject to the direction of its officers and directors. (AR Ex. 1-17; AR page I-101; CST App. 63).

79. CST does not monitor how churches and other organizations in the ecclesiastical hierarchy use the marks or the Advanced Technology. CST does not receive reports, make inspections, examine books of accounts or engage in similar activities with respect to its options.

(AR Ex. 1-69; AR page I723; CST App. 233). CST has never engaged in any activity, no matter how de minimis with respect to how Scientology organizations use the marks and Advanced Technology or respect to the options in general, nor does it plan ever to do so. (AR Ex. III-346; AR pages 111-110, 111-140; CST App. 578, 608).

80. CST does not have to monitor use of the marks and the Advanced Technology to know whether one of the three conditions giving rise to its exercise of the options has occurred since each condition contemplates circumstances that present a fundamental threat to the very existence of the Scientology religion and Scriptures. Circumstances of this gravity will be known by many Scientologists throughout the world. As Scientologists, they are duty-bound by the highest standards of ethical and moral conduct, the Scientology Systems of Ethics, to report matters of this nature to their ecclesiastical superiors. Eventually, an ecclesiastical official will notify one or more of CST's directors, officers or staff of the circumstances, who then will take appropriate action. (AR Ex. 111-346; AR page III-110; CST App. 578).

81. CST relies on the hierarchial church to provide it and its staff with the scriptures and certain religious services necessary for it to minister to its staff. CST obtains the Scriptural writings, tapes and films for providing religious services to its staff from churches within the Scientology ecclesiastical hierarchy. (AR Ex. VII-864; CST App. 1256; AR Ex. VII-865; CST App. 1259-1265). In the relevant years, CST spent the following amounts on staff training materials:

Fiscal Year	Amount Spent
-------------	--------------

1984	\$13,674.00
------	-------------

1985	15,550.00
------	-----------

1986	14,604.00
------	-----------

TOTAL	\$43,828.00
-------	-------------

(AR Ex. VII-579; CST App. 936 (1984); AR Ex. VII-580; CST App. 951 (1985); AR Ex. VII-581; CST App. 962 (1986)). These transactions were examined in the on-site review, which the IRS district agents completed satisfactorily without any evidence of inurement of earnings. (See CST PF 150).

82. At a cost of \$.11 per sheet, CST purchases copies of Scientology policies and scriptures from Church of Scientology Western United States ("CSWUS"), which keeps a comprehensive set of all church policy and Scriptures. (AR Ex. VII-777; CST App. 1210)-. CSWUS is recognized by the IRS as exempt under section 501(c)(3). (AR Ex. VII-709; CST App. 1155-1160). (See also IRS Pub. 78 at 277 (Oct. 1989 ed)). These transactions were examined in the on-site review, which the IRS district agents completed satisfactorily without any evidence of inurement of earnings. (See CST PF 150).

83. CST has used the religion's Advanced Technology in providing religious services to its staff pursuant to an informal understanding it reached with RTC in 1982. (AR Ex. 111-346; AR page 111-143; CST App. 611). RTC has owned the exclusive right to use the Advanced Technology in the United States since 1982. (AR Ex. 111-346; AR page 111-105; CST App. 573).

84. CST must sometimes send its ministers to other churches of Scientology for higher levels of ministerial training because it does not always have staff qualified to provide the needed training. For example, CST required one staff member to receive certain ministerial training provided by FSO in Clearwater, Florida so that he could perform his ministerial duties at CST. In fiscal 1986, CST paid FSO \$1,877 for approximately three months of training for this staff member. (AR Ex. VII-741; CST App. 1183; AR Ex. VII-754; CST App. 1184-1193). This transaction was examined in the on-site review, which the IRS district agents completed satisfactorily without any evidence of inurement of earnings. (See CST PF 150).

85. In May 1986, CST paid Church of Scientology Western United States \$430.00 to conduct a case folder review of Leo Johnson, CST's secretary and a CST staff member, by a highly trained auditor because CST does not have a qualified auditor on staff. (AR Ex. VII-877; CST App. 1283). This transaction was examined in the on-site review, which the IRS district agents completed satisfactorily without any evidence of inurement of earnings. (See CST PF 150).

86. When CST's exemption is recognized it will receive title to the Scientology religious copyrights, patents and other properties that Mr. Hubbard owned during his life, other than the religious marks and the Advanced Technology that he previously gave to RTC. (AR Ex. 111-346; AR page III-111; CST App. 579). While these properties are used by churches and other organizations in the hierarchical church, CST will not use these properties in any way that would involve it in the operations of the Scientology religious hierarchy. CST will maintain all licensing and literary arrangements in accordance with the Scriptures. CST plans to continue administering these properties through a separate



entity that will manage its literary and financial affairs. This managing entity will be either a wholly owned subsidiary of CST, a nonproprietary nonprofit corporation, or Author Services, Inc., a nonproprietary corporation that performed these services for Mr. Hubbard during his lifetime. (AR Ex. V-534; AR pages V-25 to V-26; CST App. 809-810). In all events, any management fees CST may pay this entity will be reasonable in amount for services that are reasonable and necessary for managing the properties. (AR Ex. V-534; AR pages V-41 to V-42; CST App. 825-826).

87. Author Services, Inc. ("ASI") is nonproprietary in that all its outstanding shares of stock are employee-owned pursuant to a Stock Redemption Agreement that prohibits them from selling their stock except on separation from employment and then only to ASI for \$1.00 a share. ASI has never paid dividends to its shareholders. (AR Ex. V-534; AR page V-26; CST App. 810; AR Ex. V-542; AR pages V-94 to V-102; CST App. 828-836).

88. Neither CST nor its separate literary and financial managing entity will set or influence the setting of prices for religious books services or materials -- CST simply will continue prior practices and permit the ecclesiastical management of the religion (i.e., CSI) to set all prices for religious materials, as CSI has in the past. (AR Ex. V-534; AR pages V-41 to V-42; CST App. 825-826).

89. CST cannot be involved in any activity relating to the practice or management of the religion (other than internally with respect to its own staff) or it would become part of the hierarchy of ecclesiastical management, which would compromise CST's objective of preserving the religion. (AR Ex. 111-346; AR page 111-95; CST App. 563).

90. CST does not permit any organization or individual to remove materials from its premises, but it will provide copies of the materials to Scientology organizations on request. In all cases, CST charges the organization the cost of reproduction, unless the cost is de minimis. (AR Ex. V-534; AR page V-36; CST App. 820). CST does not, however, make any representation as to the authority of the materials; any question as to the authority of the Scriptures must be answered by organizations within the hierarchical church. (AR Ex. V-534; AR pages V-39 to V-40; CST App. 823-824).

91. CST has provided copies of Scriptural materials to other churches only on a few occasions. Once or twice CST provided RTC a copy of a tape or other material for reference purposes. CST provided two sets of the taped Scriptures to CSI for use as master reference resources. (AR Ex. V-534; AR page V-37; CST App. 821). In each case CST received full value for the costs of producing the tapes -- \$23,149.00 in fiscal year 1984 (AR Ex. VII-579; CST App. 937), \$4,525.00 in fiscal year 1985 (AR Ex. VII-580; CST App. 952), and \$9,113.00 in fiscal year 1986. (AR Ex. VII-581; CST App. 963). CST also has lent a set of the taped Scriptures to CSI for transcription to text. In exchange for this loan, CSI will provide CST a complete transcription of all the tapes that CST can use for archival purposes. (AR Ex. V-534; AR page V-37; CST App. 821). These transactions were examined in the on-site review, which the IRS district agents completed satisfactorily without any evidence of inurement of earnings. (See CST PF 150).

92. Requests for copies of the Scriptures come from CSI in connection with updating, reviewing or compiling the various policy letters, bulletins and issues that make up the religion's written Scriptures. Individuals bring their own photocopying paper to CST and do their own copying so that CST incurs no costs in making these copies. While this activity constitutes only a very minor part of CST's overall activities, CST plans to provide CSI with a complete microfiche copy of the written Scriptures (for costs of reproduction) so that this activity will diminish to a de minimis level or cease altogether. (AR Ex. V-534; AR pages V-37 to V-38; CST App. 821-822).

93. CST has purchased from Golden Era Productions ("Gold") for storage in the vaults it will construct multiple copies of Scriptural materials such as cassette tapes, instruction films, etc., currently used by the hierarchical church. (AR Ex. VII-864; CST App. 1257; AR Ex. VII-866; CST App. 1266-1271). Gold is a division of CSI (AR Ex. 11-76; AR page 11-195; CST App. 381) which manufactures and produces Scientology dissemination material on film, video tapes, cassettes and reel-to-reel tapes and maintains studios and equipment for these purposes. (AR Ex. 11-76; AR page 11-159; CST App. 345). the relevant years, CST paid the following amounts to Gold for Scriptural materials for its archival purposes:

Fiscal Year	Amount Paid
-------------	-------------

1984	\$43,601.00
1985	11,360.00
1986	30,072.00
TOTAL	\$85,033.00

(AR Ex. VII-579; CST App. 936 (1984); AR Ex. VII-580; CST App. 951 (1985); AR Ex. VII-581; CST App. 962 (1986)). These transactions were examined in the on-site review, which the IRS district agents completed satisfactorily without any evidence of inurement of earnings. (See CST PF 150).

94. In 1986; CST made occasional payments to other churches of Scientology and to individual Scientologists who have assisted it in collecting debts owed by CST's former staff members. No recipient of such payments received more than \$600 in any of the years in question. (AR Ex. VII-875; CST App. 1280-1281). These transactions were examined in the on-site review, which the IRS district agents completed satisfactorily without any evidence of inurement of earnings. (See CST PF 150).

95. CST makes payments to other churches of Scientology for rental of office space in Los Angeles and for occasional temporary housing of its staff. (AR Ex. VII-675; CST App. 1144-1145). For example, CST pays one-half the cost (\$20.00 per week) of berthing Leo Johnson, CST's secretary and a CST staff member, in a building in Los Angeles owned by Celebrity Centre International ("CC INT"), a church of Scientology. (AR Ex. VII-676; CST App. 1146). During fiscal year 1986, CST incurred \$177,470 in occupancy expenses (AR Ex. VII-581; CST App. 962). These expenses included rent and utilities for property leased from Church of Scientology Religious Trust ("CSRT") at \$.9 per square foot per week (\$4.68 per year). (AR Ex. VII-583; CST App. 981). CSRT was recognized by the IRS as exempt under section 501(c)(3) in 1983. (AR Ex. VII-709; CST App. 1155-1160). (See also IRS Pub. 78 at 277 (Oct. 1989 ed.; id. at 14, June 1990 Supp.)). CSRT owns the major properties in Los Angeles and Riverside Counties, California, which are used as church premises by CSI, RTC, and other churches of Scientology. (AR Ex. 11-76; AR page 11-222; CST App. 407). CST leased 3,612 square feet from CSRT up to October 20, 1986 for a weekly rent of \$325.08. After October 20, 1986, CST leased 1,292 square feet from CSRT for a weekly rent of \$116.28. (AR Ex. VII-712; CST App. 1161).

These transactions were examined in the on-site review, which the IRS district agents completed satisfactorily without any evidence of inurement of earnings. (See CST PF 150).

96. In fiscal 1986, CST rented computer equipment from International Network of Computerized Management ("INCOMM") for \$2,900.00 on one occasion for a special project. (AR Ex. VII-794; CST App. 1211; AR Ex. VII-795; CST App. 1212-1217). INCOMM is a division of CSI that manages and operates a computer system for the hierarchical church. (AR Ex. 11-76; AR pages 11-157 to II159; CST App. 343-345). This transaction was examined in the onsite review, which the IRS district agents completed satisfactorily without any evidence of inurement of earnings. (See CST PF 150).

97. In fiscal 1986, CST purchased a duplicating machine from a Scientology Mission in Texas because CST needed to replace an irreparable duplicating machine. After conducting some research, CST determined that the Mission's asking price was well below area prices for comparable machines and thus decided to make the purchase from the Mission. (AR Ex. VII-908; CST App. 1305). This transaction was examined in the on-site review, which the IRS district agents completed satisfactorily without any evidence of inurement of earnings. (See CST PF 150).

98. On April 23, 1987, CST paid Church of Scientology of Los Angeles \$460 for a mailing list of Scientologists to use in its recruiting of staff members. (AR Ex. VII-895; CST App. 1301-1302; AR Ex. VII-896; CST App. 1304). This transaction was examined in the on-site review, which the IRS district agents completed satisfactorily without any evidence of inurement of earnings. (See CST PF 150).

99. In fiscal 1986, CST made four small personal loans to the following CST staff personnel: Jim Isaacson, Tom Vorm, Leo Johnson and Joe Murphy. There were no formal loan notes nor was interest charged. In each case CST made the loan because the particular staff member faced an unexpected emergency or other urgent financial matter without sufficient funds. Since CST provides staff only a nominal allowance each week, the staff involved had no personal cash

reserves and would have been forced to leave CST for a prolonged period of time in order to raise the amount needed. Each loan was approved through CST's strict financial procedures, including review and approval by its Advisory and Executive Committees.

Mr. Isaacson borrowed \$325.00 from CST in order to attend to an emergency involving a death in the family. This loan has since been repaid. Mr. Vorm borrowed \$967.64 from CST when he needed to take a short leave to handle a personal family situation. This loan was repaid within the fiscal year in question. Mr. Johnson, CST's secretary, borrowed \$350 to handle an expense incurred as a result of a car accident. This loan has since been repaid. Joe Murphy borrowed \$572.93 for a personal financial emergency. Mr. Murphy is currently out of the Sea Org and in bankruptcy so he has not yet paid off this debt. (AR Ex. VII-870; CST App. 1273-1274; AR Ex. VII-871; CST App. 1275-1276; AR Ex. VII-872; CST App. 1277; AR Ex. VII-873; CST App. 1278).

These transactions were examined in the on-site review, which the IRS district agents completed satisfactorily without any evidence of inurement of earnings. (See CST PF 150).

100. Golden Era Productions ("Gold") maintains an intensive religious rehabilitation program for its staff members. The program consists of Scientology scriptural study, worship, and physical work. CST did not have such a program and therefore sent a CST staff member during fiscal year 1986 to Gold to take part in its program. CST paid Gold \$5.00 per week for the cost of supplies used in the program, such as paper, pens, file folders, etc. (AR Ex. VII-736; CST App. 1172-1173). The transaction was examined in the on-site review, which the IRS district agents completed satisfactorily without any evidence of inurement of earnings. (See CST PF 150).

101. CST's current trustees, directors, and officers are as follows:

Trustees

Terri Gamboa  
Marion Meisler  
Lyman Spurlock

Directors

Dan Przybylski  
Nancy O'Meara  
Russ Bellin

Officers

Lyman Spurlock - President  
Dan Przybylski - Vice President  
Nancy O'Meara - Treasurer

Leo Johnson - Secretary

(AR Ex. VII-581; CST App. 976). Of the individuals named above, the following have affiliations with ASI: Terri Gamboa Marion Meisler Lyman Spurlock

In addition, Lyman Spurlock is a trustee of RTC. The only function of RTC's trustees is "the election and removal of Directors." (AR Ex. 1-46; AR page 1-388; CST App. 182).

Affiliation(s)

President, director and shareholder (AR Ex. V-534; AR page V-26; CST App. 810)  
Employee (AR Ex. 1-49; AR page 1-429; CST App. 192)

Employee (AR Ex. II-GGG; AR page 11-1514; CST App. 544)

VIII. CST'S ADMINISTRATIVE PROCEEDING .BEFORE THE IRS

A. CST's Application For Recognition of Exemption and the Administrative Proceeding Up to the Initial Adverse Ruling

102. On August 26, 1983 CST applied for recognition of its exemption under Code section 501(c)(3), effective May 28, 1982, its date of incorporation, by filing an IRS Form 1023 with the IRS. (AR Ex. 1-2; AR pages 1-2 to 1-14; CST App. 1-14). CST enclosed with its application its Articles of Incorporation (AR Ex. 1-3; AR pages 1-15 to 1-20) and its Bylaws. (AR Ex. 1-4; AR pages 1-21 to 1-58).

103. CST's Articles of Incorporation expressly forbid CST from engaging in any electoral-activities and from engaging in more than an insubstantial amount of lobbying activities. (CST PF 1). On its Form 1023, in response to the question "Does the organization engage in activities tending to influence legislation or intervene in any way in political campaigns?", CST responded "No." (AR Ex. 1-2; AR page 1-5; CST App. 5). The IRS raised no questions about lobbying or electoral activities at any time during CST's administrative proceeding and the record contains no evidence of either activity. (Entire Record).

104. At the time CST filed its application, CSI and RTC also had exemption applications pending before the IRS. (Comp., Ans. 55; AR Ex. 111-346; AR page 111-89; CST App. 557). Throughout CST's administrative proceeding, the IRS consistently refused to consider CST's application separately from those of CSI and RTC:

Religious Technology Center, Church of Spiritual Technology, and Church of Scientology International are all engaged in activities which are mutually supportive of one common goal. Therefore, we are convinced that the activities of all three organizations must be considered in determining whether any one of them is entitled to recognition of exemption.

(AR Ex. 111-344; AR page,III-76A; CST App. 552).

105. Between the date CST the end of 1985, the IRS issued filed its exemption application and seven letters to CST asking more than 130 questions about its religious and financial affairs. CST provided the IRS responses to all questions raised by those letters relevant to CST's exempt status, as follows:

#### IRS Inquiry

1. Jan. 26, 1984, 6 pages  
(AR Ex. 1-15; AR pages 1-90 to 1-95)
2. May 30, 1984, 3 pages  
(AR Ex. 1-24; AR pages 1-211 to 1-213)
3. July 30, 1984, 5 pages  
(AR Ex. 1-26; AR pages 1-216 to 1-220)
4. October 5, 1984, 8 pages  
(AR Ex. 1-30; AR pages 1-234 to 1-241)
5. January 18, 1985, 11 pages  
(AR Ex. 1-43; AR pages 1-372 to 1-382)
6. April 22, 1985, 19 pages  
(AR Ex. 1-58; AR pages 1-453 to 1-471)
7. July 26, 1985, 3 pages  
(AR Ex. 1-71; AR pages 1-730 to 1-732)

#### CST Response

May 18, 1984, 5 pages,  
6 exhibits totaling 109 pages  
(AR Ex. 1-17 to 1-23; AR pages I-97 to I-210)

June 10, 1984, 2 pages  
(AR Ex. 1-25; AR pages 1-214 to 1-215)

September 10, 1984, 10 pages  
(AR Ex. 1-28, 1-29; AR pages I-224 to I-233)

November 7, 1984, 6 pages, 1 exhibit of 1 page  
(AR Ex. 1-38, 1-39; AR pages I-351 to I-357)

March 21, 1985, 11 pages,  
8 exhibits totaling 51 pages  
(AR Ex. 1-46 to 1-54; AR pages I-386 to I-447).

June 26, 1985, 7 pages  
(AR Ex. 1-69; AR pages 1-722 to 1-728)

September 1, 1985, 4 pages (AR Ex. 1-75, 1-76; AR pages I-747 to I-750)

## B. The Initial Adverse Ruling

106. On January 7, 1986, the IRS issued a 62-page initial adverse determination letter to CST. On the same day, the IRS issued virtually identical initial adverse determination letters to CSI and RTC. (Comp., Ans. q58; AR Ex. 1-79; AR pages 1-753 to I814, CST App. 245-306).

107. The IRS discussion of commercialism in the initial adverse ruling was solely in the context of alleged private benefit to Mr. Hubbard. (AR Ex. 1-79; AR pages 1-782 to 1-808; CST App. 274-300). Indeed, the two major headings of the letter under "Rationale" were entitled "Licensing and Assignment Agreements Benefit the Private Interests of L. Ron Hubbard," (AR Ex. 1-79; AR page 1-782; CST App. 274), and "Commercial Operations Benefit the Private Interests of L. Ron Hubbard." (AR Ex. 1-79; AR page 1-801; CST App. 293). The letter made these rulings with respect to CST even though CST did not engage in any of the alleged commercial activities:

Although CST is not engaged in direct sales of goods and services, it plays a key role in furthering the delivery of sales and services by the other organizations. CST funds research to improve the E-Meter, thereby improving the prospects for more E-Meter sales. It collects, catalogues, and stores the scriptures of the religion, which authenticates the materials and facilitates the task of making portions of them available for use in publications which are sold by L. Ron Hubbard and/or his for-profit licensees.

(AR Ex. 1-79; AR page 1-801; CST App. 293).

108. In its initial adverse ruling, the IRS took the position that CST's dissolution clause did not meet the second requirement of the organizational test because it permitted CST to make dissolution distributions to organizations that simply are "entitled to receive" tax-exempt status rather than to organizations that actually have received tax-exempt status.

(Comp., Ans. 1 62; AR Ex. 1-79; AR page 1-813; CST App. 305).

## C. CST's Protest of the Initial Adverse Ruling

109. On July 3, 1986, CST filed an extensive protest that provided the IRS with 125 pages of information concerning the Scientology religion, the hierarchical church, its activities, and Mr. Hubbard's relationship with the church, 240 pages of argument, more than 1,000 pages of supporting exhibits, and more than 29,000 pages and 500 recorded hours of Scientology Scriptures. RTC and CSI filed identical protests.

(Comp., Ans. 1 66; AR Exs. 11-71 to 11-322; AR pages II-1 to II-2617).

110. CST's protest countered each and every one of the challenges contained in the initial adverse letter and showed

that the whole underpinning for the IRS's position -- benefit to Mr. Hubbard -- ended with his death.

(AR Ex. 11-76; AR pages 11-73 to 11-550; AR Ex. VI-8; AR page VI-93; CST App. 846).

111. In the protest, CST challenged the IRS's dissolution clause position on three grounds. First, CST pointed out that the dissolution clause was superfluous because other provisions in its articles of organization expressly dedicated all of its assets to section 501(c)(3) purposes: Second, CST noted that it did not have to have an express provision in its articles of organization because in Revenue Procedure 82-2, 1982-1 C.B. 367, the IRS had ruled that an express provision was not necessary for corporations formed under the California nonprofit charitable corporations statute, since the statute itself contained the necessary language. Finally, CST reminded the IRS that it had submitted a proposed amendment to its dissolution clause for IRS approval several months earlier but the IRS had never responded to its proposal. (AR Ex. 11-76; AR pages 11-315 to 11-320; CST App. 436-441). In the interim, CST adopted the amendment. (AR Ex. 11-290; AR pages II2007 to 11-2008; CST App. 535-536).

#### D. CST's 1987 Conference

112. In January of 1987, CST and the other applicants jointly met with three representatives of the Exempt Organizations Technical Division of the IRS National Office (the "National Office") -- Marcus Owens, Marvin Friedlander and Roderick Darling -- to discuss the initial adverse letters and the extensive protests filed by the Applicants. The conference lasted six days. (Comp., Ans. 1 67). The conference substantially narrowed or clarified the issues the Service had raised. (AR Ex. VI-8; AR page VI-93; CST App. 846). Following the initial adverse ruling, CST had amended the dissolution clause in its articles of incorporation to limit dissolution distributions only to organizations "described in section 501(c)(3)," (Comp., Ans. 1 65). National Office personnel attending the conference said they no longer disputed that CST was organized exclusively for exempt purposes. (Comp., Ans. Q 69; AR Ex. 111-346; AR page 111-91; CST App. 559). Since then, the IRS has never questioned whether CST meets the organizational test under section 501(c)(3). The issue was not raised in the IRS's final ruling nor has it been raised in this proceeding since CST's conference. (Entire Record). The National office personnel also agreed that Mr. Hubbard's death significantly altered the issue of inurement for later periods.

(AR Ex. VI-8; AR page VI-93; CST App. 846).

113. Discussion at the six-day conference focused on three major issues -- CST's activities, benefit to Mr. Hubbard, and commercialism. Accordingly, CST, CSI and RTC decided to supplement their administrative records with the facts and arguments discussed at the conference through three separate submissions, each addressing one major issue. First, CST would make a separate submission to establish that it was an autonomous organization and entitled to exemption regardless of the exempt status of RTC or CSI, or any alleged prior relationship with Mr. Hubbard. Second, CSI and RTC would make a joint submission to establish that they operated exclusively for religious purposes rather than a commercial purpose. Third, CSI and RTC then would make another joint submission for periods prior to Mr. Hubbard's death to establish that any benefit he received as a result of Applicants' activities was reasonable and incidental in comparison to the benefit received by the public at large. (AR Ex. VI-8; AR page VI-94; CST

#### E. CST's First Supplemental Submission

114. On May 5, 1987, CST filed a supplemental submission that provided the IRS substantial information on the nature and extent of its activities, including an 80-page narrative description of CST's formation, governance, financial affairs and preservation program, a 45-minute videotape presentation of CST's facilities and preservation activities and 23 exhibits totalling 923 pages. (Comp., Ans. q 70; AR Exs. 111-345 to 111-372; AR pages 111-77 to III-1229a). This supplemental submission addressed all outstanding issues affecting CST's exempt status. (AR Ex. VI-8; AR page VI-94; CST App. 847; Compare AR Ex. 111-346; AR page 111-87; CST App. 555 with AR Ex. 1-79; AR pages 1-782, 1-801; CST App. 274, 293).

115. CST's supplemental submission demonstrated that the IRS's understanding of its option rights was materially incorrect and that only CST -- not Mr. Hubbard -- would benefit if it exercised the options. In particular, Mr. Hubbard could not reappoint any rights he had previously assigned if CST exercised the options; rather, the express terms of the option agreements permit CST, and only CST, to acquire the rights Mr. Hubbard had assigned if the options are exercised. (AR Ex. 111-346; AR pages 111-187 to 111-188; CST App. 655-656).

116. The National office responded to CST's supplemental submission by letter of July 17, 1987 in which it stated that

while CST's representatives had "adequately clarified" some matters during a July 14, 1987 meeting, fifteen other matters were set forth in writing to be clarified, including: specific relationships with certain other entities; pending lawsuits against CST; whether CST made any representations as to the authenticity of the materials it collected; whether CST provided the materials it collected to other organizations; and whether Mr. Hubbard or any other Scientology organization benefited from this collection activity. (Comp., Ans. q 73; AR Ex. 111-375; AR pages 111-1231 to 111-1234; CST App. 782-785).

#### P. CST's Second Supplemental Submission

117. CST sent the IRS a forty-two page letter dated September 16, 1987 (CST's second supplemental submission) responding to the IRS's letter dated July 17, 1987 requesting additional information. (Comp., Ans. 1 74; AR Ex. V-534; AR pages V-2 to V-43). CST also submitted ten exhibits with this letter totalling eighty-four pages. (AR Ex. V-535 to V-544; AR pages V-44 to V-127).

118. In its September 16, 1987 submission, CST informed the IRS that it did not make any representations as to the authenticity of the materials it collects to any entity. (AR Ex. V-534; AR pages V-39 to V-40; CST App. 823-824).

119. In the interim between the National Office's July 17, 1987 follow-up questions to CST and CST's September 16, 1987 responses, CSI and RTC filed Part I of their supplemental submission. This submission dealt with the issue of alleged commercial purposes ("commercialism"). This submission provided the IRS with detailed information concerning the hierarchical church's policies with respect to setting prices for books and other materials, setting contribution rates for services, and managing and spending financial reserves. (Comp., Ans. y 79; AR Ex. VI-8; AR pages VI-94 to VI-95; CST App. 847-848).

#### G. The IRS's Questions Regarding CST's Relationships With Other Entities

##### 1. FBI and Armstrong Cases

120. In an October 5, 1984, letter, the IRS expressed concerns about allegations in then-recent court cases, *Founding Church of Scientology of Washington, D.C., Inc. v. Director, Federal Bureau of Investigation*, Civ. No. 78-0107 (D.D.C.), ("FBI" case) and *Church of Scientology of California v. Armstrong*, No. C 420153 (Cal. Super. Ct. July 20, 1984) ("Armstrong" case) and asked CST for its comments. (AR Ex. 1-30; AR pages 1-234 to 1-235, 1-237 to 1-239; CST App. 152-153, 155157). CST responded to these concerns by letter dated November 7, 1984. CST advised the IRS that "[t]his organization is not a party to any of these proceedings, is not involved in any of them in any other capacity and is not referred to in any of them." CST further noted that the documents from the FBI case from which the IRS recited various allegations 'do not include any reference to this organization, the formation of this organization, its purposes and activities, its relationships with any individual or organization or its participation in any alleged plan such as you refer to. This organization is not part of any such plan; it was not formed as a part of any such plan; staff members, and it is not controlled by Mr. Hubbard. And there is no allegation or statement to the contrary in any of the documents to which you refer., With respect to the testimony and it is operated and controlled by its officers, directors and declarations in FBI and Armstrong, CST advised the IRS that its concerns involved periods of time "prior to the organization of (CST)" and that "the testimony-and declaration [do] not mention this organization or any of its activities directly or by description." More specifically, CST advised the IRS that:

In short, the proceedings and documents which you ask us to comment upon relate to organizations other than this organization, to alleged events which occurred prior to the incorporation of this organization, to an alleged plan which (even as alleged) did not include this organization, to alleged control by Mr. Hubbard of organizations other than this organization and to alleged transactions which did not in any way involve this organization.

In light of this, we disagree with your assertion (in the second paragraph on page 1 of your letter) that these matters bear directly on your qualification as an organization operated exclusively for charitable, religious or other exempt purposes.

(AR Ex. 1-38; AR pages 1-351 to 1-354; CST App. 160-163).

On January 18, 1985, the IRS sent CST a letter in which it sought from CST certain materials referred to in the

Armstrong case. (AR Ex. 1-43; AR page 1-377; CST App. 174). With its March 21, 1985, response, CST provided two of the requested documents. (AR Ex. 1-50; AR pages 1-432 to 1-435; CST App. 195-198). CST was unable to produce the remaining materials because they were "not in the possession of, under the control of or available to this corporation" (AR Ex. 1-46; AR page 1-388; CST App. 182). In its March 21, 1985 response, CST also addressed the IRS's assertions about CST's formation based on allegations in the Armstrong and FBI cases. (AR Ex. 1-46; AR pages 1-393 to 1-394; CST App. 187-188).

In an April 22, 1985 letter to CST, the IRS asked no specific questions about the FBI and Armstrong cases but reiterated its position that "information from other sources, as well as information from your organization, is highly relevant to our consideration of your application." (AR Ex. 1-58; AR pages 1-453 to 1-454; CST App. 209-210). The IRS letter then restated the IRS "'concerns" over the FBI and Armstrong cases and asked CST if it "wish[ed]" to submit any comments upon these matters.' (AR Ex. 1-58; AR pages 1-461 to 1-466; CST App. 217-222). In response, in a June 26, 1985, letter, CST stated that these assertions "do not request any information of the organization. They repeat your argument in support of your refusal to rule upon our application, and ask us to comment upon the matters which you assert in support of that argument." CST's response then went on to object to the inclusion of those materials in its record and then requested the IRS to respond to a number of specific questions about CST's operations to identify the exact status of its application. (AR Ex. 1-69; AR pages 1-725 to 1-728; CST App. 235-238). In response, the IRS asked only two more questions, neither of which pertained to the FBI or Armstrong cases (AR Ex. 1-71; AR page 1-730 to 1-731; CST App. 239-240) and both of which CST answered. (AR Ex. 1-76; AR pages 1-748 to 1-750; CST App. 242-244).

In its January 7, 1986 initial adverse ruling letter, the IRS identified only a few specific questions which it claimed were unanswered by CST, none of which involved the allegations from the Armstrong or FBI cases. The IRS merely asserted that information had not been provided about other organizations to resolve its "concerns" arising out of their supposed "connections" to CST. (AR Ex. 1-79; AR pages 1-755 to 1-756, 1-769, 1-798, 1-800; CST App. 247-248, 261, 290, 292). CST's protest contained an entire section of twenty-five pages (AR Ex. 11-76; AR pages 11-517 to 11-541; CST App. 469-493), with eighteen exhibits totaling more than 400 pages (AR Ex. 11-305 to 11-322; AR pages 11-2178 to 11-2617), readdressing and refuting the allegations from the FBI and Armstrong cases. The Armstrong allegations were further discussed and refuted in CST's May 5, 1987 supplemental submission. (AR Ex. 111-346; AR pages 111-185 to 111-186; CST App. 653-654).

The IRS National office asked CST no further questions about its "concerns" arising from the FBI and Armstrong cases (AR Parts III, V and VI) and on September 23, 1987 indicated it had no further questions of CST. (See CST PF 130). No questions were asked about the FBI or Armstrong cases during CST's on-site review. (AR Part VII).

## 2. Religious Research Foundation (NRRFM)

In its July 30, 1984, letter, the IRS asked CST the following question:

6. In a recent newspaper article (attached) from the New York Times dated July 11, 1984, there is information stated about which we have no knowledge.

\* \* \*

c. Do you have any connection with the Religious Research Foundation . . . mentioned in the article as serving Mr. Hubbard's interests?

(AR Ex. 1-26; AR pages 1-218 to 1-219; CST App. 137-138). On September 10, 1984, CST responded as follows:

c. This organization has no connection with Religious Research Foundation

(AR Ex. 1-29; AR pages 1-232 to 1-233; CST App. 150-151).

In an October 5, 1984, letter, the IRS raised certain concerns about allegations in two then-recent court cases, *Founding Church of Scientology of Washington, D.C., Inc. v. Director, Federal Bureau of Investigation*, Civ. No. 78-0107

(D. D. C.), ("FBI" case), and *Church of Scientology of California v. Armstrong*, No. C 420153 ("Armstrong" case),



including certain allegations about RRF, and asked CST for its comments. (AR Ex. 1-30; AR pages 1-234 to 1-235, 1-238, 1-239; CST App. 152-153, 156, 157). The letter, however, asked no specific question about RRF. (Id.) CST's November 7, 1984, response to the "concerns" about RRF was included in its response to the IRS's more general "concerns" about the FBI and Armstrong cases. (See CST PF 120).

On January 18, 1985, the IRS sent CST a letter in which it sought additional information from CST, some of which pertained to an asserted connection with RRF. (AR Ex. 1-43; AR pages 1-379 to 1-380; CST App. 176-177). CST responded to this assertion in its March 21, 1985 letter as follows:

You stated that you have gleaned information 'about control being exercised over the Scientology organizations . . . by entities and committees about which little is known.'" You refer to . . . Religious Research Foundation.

You stated that these "matters" were not disclosed by this organization \* \* \* This organization has no involvement at all in any of the other matters you mention. Further, we understand the gist of your complaint to be that we did not disclose to you that control is exerted over this organization by . . . some other entity. But it is not, and we can hardly be criticized for failing to assert that it was or for failing to anticipate that you would reach the erroneous conclusion that it is.(AR Ex. 1-46; AR pages 1-391 to 1-392; CST App. 185-186).

In an April 22, 1985 letter to CST, the IRS restated its "concerns" over RRF and asked CST if it "wish[ed] to submit any comments upon these matters." (AR Ex. 1-58; AR page 1-462; CST App. 218). CST's June 26, 1985 letter included its response to the IRS "concerns" about RRF within its response to the IRS's more general "concerns" about the FBI and Armstrong cases. (See CST PF 120).

In its January 7, 1986 initial adverse ruling letter, the IRS identified only a few specific questions which it claimed were unanswered by CST, none of which involved RRF. (AR Ex. I79; AR pages 1-753 to 1-815; CST App. 245-307). The IRS merely asserted that information had not been provided about other organizations including RRF, to resolve its "concerns" over their supposed "connections" to CST arising out of the FBI and Armstrong cases. (AR Ex. 1-79; AR pages 1-755 to 1-756, 1-769, 1-798, 1-800; CST App. 247-248, 261, 290, 292). CST's protest contained an entire section of twenty-five pages (AR Ex. 11-76; AR pages 11-517 to 11-541; CST App. 469-493), with eighteen exhibits totaling more than 400 pages (AR Ex. 11-305 to 11-322; AR pages 11-2178 to 11-2617), reasserting and refuting the allegations from the FBI and Armstrong cases. The Armstrong allegations were further discussed and refuted in CST's May 5, 1987 supplemental submission. (AR Ex. 111-346; AR pages 111-185 to 111-186; CST App 653-654).

The IRS National office asked CST no further questions about its "concerns" over RRF (AR Parts III, V and VI) and on September 23, 1987 indicated it had no further questions of CST. (See CST PF 130). No specific questions were asked about RRF during CST's onsite review. (AR Part VII).

### 3. Cancorp Investment Properties, Inc. ("Cancorp")

In a letter of April 22, 1985, the IRS asked CST the following question:

Your letter of March 21, 1985, indicates that some of your present officers, directors, or trustees were previously associated with Cancorp Investment Properties, a British Columbia corporation. What is Cancorp? What activities does it engage in? Does it have any relationship with Church of Spiritual Technology? Does it have any relationship with other Scientology organizations? Does it have any relationship with L. Ron Hubbard and his personal financial interests? (AR Ex. 1-58; AR page 1-467; CST App. 223). By letter dated June 26, 1985, CST responded to the IRS's questions:

You state that our letter of March 21, 1985, indicates that "some of your present officers, directors or trustees were previously associated with Cancorp Investment Properties.

The referenced letter made no mention of that corporation except in Exhibit C, the job histories of the present officers, directors and trustees. Two of the present officers (one of whom is also a director) worked for that corporation during 1982 prior to their employment by this applicant. This corporation (CST) does not have and never has had any

connection, relationship or transaction whatsoever with that corporation [Cancorp].

(AR Ex. 1-69; AR page 1-722; CST App. 232).

In addition to these specific questions, the April 22, 1985 letter to CST restated the IRS's "concerns" over Cancorp and asked CST if it "wish[ed] to submit any comments upon these matters." (AR Ex. 1-58; AR pages 1-458 to 1-459; CST App. 214-215). CST's June 26, 1985 letter included its response to the IRS "concerns" about Cancorp within its response to the IRS's more general "concerns" about the FBI and Armstrong cases. (See CST PF 120).

In its January 7, 1986 initial adverse ruling letter, the IRS identified only a few specific questions which it claimed were unanswered by CST, none of which involved Cancorp. (AR Ex. 1-79; AR pages 1-753 to 1-815; CST App. 245-307). The IRS merely asserted that information had not been provided about other organizations including Cancorp, to resolve its "concerns" over their supposed "connections" to CST arising out of the FBI and Armstrong cases. (AR Ex. 1-79; AR pages 1-755 to 1-756, 1-769, 1-798, 1-800; CST App. 247-248, 261, 290, 292). CST's protest contained an entire section of twenty-five pages (AR Ex. 11-76; AR pages II-517 to 11-541; CST App. 469-493), with eighteen exhibits totaling more than 400 pages (AR Ex. 11-305 to 11-322; AR pages 11-2178 to 11-2617), readdressing and refuting the allegations from the FBI and Armstrong cases. The Armstrong allegations were further discussed and refuted in CST's May 5, 1987 "supplemental submission." (AR Ex. 111-346; AR pages 111-185 to 111-186; CST App. 653-654). The IRS National Office asked CST no further questions about its "concerns" over Cancorp (AR Parts III, V and VI) and on September 23, 1987 indicated it had no further questions of CST. (See CST PF 130). No specific questions were asked about Cancorp during CST's on-site review. (AR Part VII).

#### 4. The International organizations

The International Association of Scientologists ("IAS") was created in 1984 in England by a convention of Scientologists representing Scientology churches all over the world. It is an unincorporated association, having as members individuals, churches of Scientology and national associations of Scientology, and is governed by a Board of Directors. IAS is the only current membership system or organization recognized by CSI and the hierarchical church. (AR Ex. 11-76; AR pages 11-199 to 11-200; CST App. 385-386; AR Ex. VII-878; CST App. 1284-1285).

The purposes of IAS are to assure the continued practice and expansion of the Scientology religion throughout the world, to assist churches of Scientology when needed and to maintain communications with Scientologists on matters of common concern. IAS is not part of the hierarchical church of Scientology. IAS is funded by membership dues and contributions, including, in the past, dues paid by United States Churches for their staff members. (AR Ex. VII-878; CST App. 1284-1285).

Since early 1987, IAS has provided its membership to Church of Scientology staff members free of charge. Prior to 1987, CST paid for lifetime IAS memberships for its members who were not previously members of IAS before joining CST. In its fiscal year ending April 30, 1987, CST paid for lifetime IAS memberships for four of its staff, none of whom was an officer, director or trustee. (AR Ex. VII-878; CST App. 1284-1285).

CST described IAS in its Protest. (AR 11-76; AR pages 11-199 to 11-200; CST App. 385-386). During the on-site review, the IRS reviewed CST's specific financial transactions with IAS, along with a copy of IAS's constitution (AR Ex. VII-879; CST App. 1286-1296), a sample copy of IAS's membership magazine, IMPACT (AR Ex. VII-880), and an annual report to members (AR Ex. VII-881). IRS district agents completed the on-site review without finding any evidence of inurement of earnings. (See CST PF 150).

124. SOR Management Services Ltd. ("SORMS") was incorporated in 1985 in the United Kingdom to act as an agent for United States church corporations and trusts holding central reserve accounts. It banks, disburses, and accounts for reserves funds for certain Scientology entities and ensures efficiency in the handling of reserves transactions pursuant to contracts with these entities. Although organized as a for-profit corporation, SORMS is staffed entirely by Sea Org members and is operated exclusively for the religious purposes of Scientology. (AR Ex. 11-76; AR page 11-219; CST App. 404).

CST described SORMS in its protest. (AR Ex. 11-76; AR page 11-216; CST App. 404). In its Supplemental Submission, CST unequivocally informed the National Office that it "does not participate in the hierarchical church's system of centralized reserves" (AR Ex. 111-346; AR page 111-135; CST App. 603), and "does not use SOR Management Services Ltd. as a banking agent for its reserves as do the Scientology organizations that participate in the central reserve" (AR Ex. 111-346; AR page 111-138; CST App. 606).

There is no evidence of any payment to or from SORMS in the record. (Entire Record).

125. Scientology International Missions Trust, International Scientology Films Trust, and International Scientology Religious Trust are all trusts that are part of the hierarchical church's system of central reserves. They are under the ecclesiastical authority of CSI, which approves on a line-item basis monthly budgets for their expenditures. (AR Ex. 11-76; AR pages 11-222 to 11-225; CST App. 407-410). There is no evidence in the record of any transaction between CST and these three trusts. (Entire Record).

126. International SOR Trust and International Publications Trust ("IPT") are described in CST's protest. International SOR Trust owned Bridge Publications, from 1982 to 1985, when it transferred the shares to IPT. IPT also is the parent of New Era Publications, the hierarchical church's publishing company for foreign countries. IPT is a Scientology religious trust governed by three trustees, one of whom is the senior CSI staff member concerned with ecclesiastical matters relating to the publication, production and dissemination of Scientology Scriptures and other religious material. (AR Ex. 11-76; AR pages 11-190 to 11-191; CST App. 376-377).

Section 7 of IPT's Instrument of Trust demonstrates that IPT is organized exclusively for religious purposes and is prohibited from making any distribution other than to organizations described in section 501(c)(3) or exclusively for section 501(c)(3) purposes:

#### 7.1 Purposes of the Trust Generally.

The purposes of the Trust are exclusively charitable, educational and religious. The Trust is organized exclusively for such purposes and shall always be operated exclusively for these purposes. More particularly, the purposes of the Trust are to forward and to bring about the improvement of mankind through publication and dissemination in the fields of art, literature, science, philosophy and religion. Its activities in pursuit of the accomplishment of these purposes shall consist of any one or more of the following, as the Trustee may in its discretion determine will best accomplish the Trust's purposes:

##### 7.1.1. Grants to Exempt Organizations.

The Trustee may make grants or contributions to, or otherwise render financial assistance to, any organization other than Trustee which is organized and operated exclusively for purposes which are the same as or similar to the purposes of the Trust, and which is an organization described in Sec. 501(c)(3) of the Internal Revenue Code, provided only that such grants, contributions, or other financial assistance are utilized solely for accomplishing such purposes.

#### 8. Limitation Upon Activities of the Trust

In furtherance of the exclusively charitable, educational and religious purposes of the trust, and to the end that the trust may be operated exclusively for such purposes, the Trust shall not be operated for the benefit of any private person, no part of the net earnings of the Trust shall inure to the benefit of any private individual either directly or indirectly; no substantial part of the activities of the Trust shall in any way consist in the carrying on of propaganda or otherwise attempting to influence legislation; and the Trust shall neither directly nor indirectly participate in or intervene in any political campaign on behalf of or in opposition to any candidate for public office, including the publishing and distribution of statements.

#### 10.3 Distribution of the Trust Assets Upon Termination

Upon termination of the trust, all assets of the Trust, including both undistributed portions of the corpus thereof and all net income therefrom, whether accumulated or otherwise undistributed, shall be distributed among one or more organizations, other than the trustee, which are described in Section 501(c)(3) of the Internal Revenue Code and which are organized and operated exclusively for purposes which are the same as or similar to the purposes of the Trust.

(AR Ex. 11-199; AR pages 11-961, 11-964, 11-972; CST App. 506, 509, 518).

There is no evidence in the record of any transaction between CST and these two trusts. (Entire Record).

127. The question the IRS asked CST in its letter dated October 10, 1986 about international organizations was initially asked of CSI, RTC, and CST, following their identical protests of the initial adverse ruling letter and prior to their 1987 joint conference. (AR Ex. 111-332; AR pages 111-55 to 111-58; CST App. 548-551; AR Ex. VI-29; AR page VI-165; CST App. 905).

128. Following the 1987 joint conference and the applicants' supplemental submissions, the IRS asked CST fifteen additional specific questions in a letter dated July 17, 1987, none of which involved "international" organizations. (AR Ex. 111-375; AR pages 111-1231 to III1234; CST App.-782-785).

129. Following receipt of CST's response to its letter dated July 17, 1987, the IRS indicated it had no further questions of CST. (See CST PF 130). However, at a meeting on December 4, 1987, the IRS subsequently indicated it wanted more information about five internationally organizations International Publications Trust, International SOR Trust,

SOR Management Services, Ltd., Scientology International Missions Trust, International Scientology Religious Trust but it agreed to request such information only from CSI, because, as with many other questions about the ecclesiastical hierarchy, CST was not in a position to answer:

Mr. Friedlander specifically notified Applicants [CST, CSI, and RTC] that the only additional information the service felt it needed (other than the (on-site] review) related to five international organizations, and he provided Applicants with a written request for the information wanted. Subsequently, the National Office and Applicants discussed this with the reviewing agents, who agreed to provide CSI with an appropriate request. CSI received the request on June 17, 1988, prior to the scheduled start of its review.

(AR Ex. VI-6; AR page VI-88; CST App. 841; AR Ex. VI-29; AR page VI-163; CST App. 903).

#### B. The on-site Review

130. At a September.23, 1987 meeting, Mr. Friedlander informed the applicants that the submission on commercialism prepared by CSI and RTC "fully satisfied" them on the issue with respect to all three Applicants and that they had no additional questions. (AR Ex. VI-8; AR page VI-95; CST App. 848)".

131. From September 23, 1987 until the issuance of the final adverse ruling, CST received no indication of any differing opinion within the IRS concerning its application in the form of additional questions about commercialism or CST's activities, nor was CST ever informed of the need to make any changes to resolve any legal concerns the IRS may have had about its activities. (AR Parts VI and VII).

132. At the September 23, 1987 meeting, Mr. Friedlander also stated that while the Service had no further questions regarding CST, it would not rule on CST's exemption before completing consideration of CSI and RTC. Mr. Friedlander then suggested that the exemption proceedings could be resolved fairly soon in the Applicants' favor for periods after Mr. Hubbard's death if the applicants conceded exemption for prior periods. (AR Ex. VI-8; AR page VI-95; CST App. 848).

133. Since CST had not participated in the activities the IRS alleged had benefited Mr. Hubbard during his life, CST refused to concede exemption for any period. (Comp. 1 81; Entire Record). CST informed the National Office that it believed it had submitted sufficient facts to establish its exemption for all periods regardless of-the exempt or nonexempt status of CSI, RTC or any other Scientology organization" (Comp., Ans. q 81; AR Ex. VI-2; AR page VI-3; CST App. 837) and indicated it was prepared to file a declaratory judgment action under section 7428. (Comp., Ans. g 81; AR Ex. VI-29; AR page VI-164; CST App. 904).

134. At the specific request of the National Office, CST < agreed to suspend its determination request and agreed not to file a declaratory judgment action under section 7428 until the National

Office had a reasonable period of time to consider a supplemental submission CSI and RTC planned to file on the issues of private benefit and inurement. CST also promised that, should CST decide a declaratory judgment action were necessary, it would give the National Office "reasonable notice" prior to filing such an action. (Comp., Ans. q 83; AR Ex; VI-2; AR pages VI-3 to VI-4; CST App. 837-838).

135. In a November 24, 1987 letter to CST's representative, Mr. Milton Cerny, Chief of the IRS Exempt Organizations Ruling Branch, stated that the Service was "actively considering" the information submitted with respect to CST's application and that the Service "appreciates the cooperation shown by the applicant." Mr. Cerny, however, stated that the Service wanted "additional information" to assure itself concerning CST's maintenance of proper books and records-that would fairly reflect its income, assets and expenditures." Mr. Cerny proposed a meeting with CST's representatives on December 4, 1987 "to discuss a mutually agreeable solution addressing this concern." (AR Ex. VI-3; AR page VI-5; CST App. 839)

136. At the December 4, 1987 meeting, Mr. Friedlander informed applicants that the National Office had two "lingering concerns" with respect to the applicants' exemption for periods after Mr. Hubbard's death -- possible inurement and the integrity of the Applicants' books and records. Mr. Friedlander said that these concerns could be put to rest if the Applicants permitted agents from the Exempt Organizations Branch of the Los Angeles District Office to review their financial records for 1986, the year of Mr. Hubbard's death. Mr. Friedlander said the review would not be a full-scale audit, would be limited to questions concerning inurement and the integrity of financial records, and would be completed within six months. (Comp., Ans. 1 84; AR Ex. VI-8; AR pages VI-95 to VI-96; CST App. 848-849).

137. At that meeting, Mr. Owens expressly acknowledged that the IRS proposal was "highly unusual" and not required by the Regulations or IRS procedures. Because of the unusual nature of the request, Mr. Friedlander said that in exchange for their cooperation, the IRS would provide the Applicants with letters assuring them of favorable determinations by a date certain unless inurement or an inadequate accounting system were disclosed. (AR Ex. VI-8; AR page VI-96; CST App. 849).

138. CST, CSI and RTC had reservations about the objectivity of District personnel. They questioned for example, whether the agents would "nit pick" every expenditure the Applicants ever made, no matter how small. Their sole concern was that the review would be conducted "objectively and expeditiously." (AR Ex. VI-8; AR page VI-96; CST App. 849). The three Applicants subsequently advised the National Office that they were willing to undergo a limited review. Representatives of the Applicants and the National Office began drafting the proposed letter of assurance. (Comp., Ans. 1 88; AR Ex. VI-8; AR page VI-96; CST App. 849).

139. On February 8, 1988, CST, CSI and RTC wrote Mr. Robert I. Brauer, the Assistant Commissioner for Employee Plans and Exempt Organizations, to request a meeting to resolve an impasse that had developed as a result of the National Office's January 15, 1988 draft letter of assurance. (Comp., Ans. 1 91; AR Ex. VI-8; AR pages VI-96, VI-99 to VI-100; CST App. 849, 852-853)

The Assistant Commissioner granted Applicants' request and met with them on March 1, 1988. (Comp., Ans. q 92). At this meeting the IRS and the Applicants resolved their differences and reached an agreement over the form and substance of the letters of assurance. During this meeting, the IRS's representatives expressly acknowledged that "considerable progress. . . had been made on (the Applicants'] exemption applications." (AR Ex. VI-14; AR page VI-114; CST App. 865). The Assistant Commissioner further assured the Applicants that the on-site review agreed to was the "last step in a long process" he believed would "result in exemption" and that he believed "exemption would be granted." Ex VI-29; AR pages VI-164 to VI-165; CST App. 904-905). The Assistant Commissioner also acknowledged that the District's agreement to be supervised by the National office during the onsite review was a "major concession" by the IRS and was made at the insistence of CST and the other Applicants. (AR Ex. VI-19; AR page VI-133; CST App. 883).

140. The National office provided CST with a new letter agreement dated March 17, 1988 (the "Settlement Agreement") that CST executed on March 21, 1988. RTC and CSI also received and executed identical settlement agreements. In its cover letter returning the executed Settlement Agreement, CST noted that while the review had "no place in the administrative and statutory scheme for initial determination of tax-exempt status," it intended to "cooperate fully" with the IRS in completing the review. (Comp., Ans. 1 93; AR Ex. VI-15, VI-16, VI-17; AR pages VI-115 to

VI-118, VI-120 to VI-125; CST App. 866-869, 870-875).

141. The Settlement Agreement stated that the purpose of the review was to "determine the integrity of your financial and accounting systems" and "verify that no part of your net earnings inures to the benefit of any private shareholder or individual and that there is no other disqualifying activity." (Comp., Ans. 1 95; AR Ex. VI-17; AR page VI-122; CST App. 872).

142. The Settlement Agreement included the following provisions:

1. The Service will conduct a review of the financial operations and activities of your organization. While the agents who will be conducting the review will be employees of the Western Region of the Internal Revenue Service, operating under the direct supervision of local management, the National Office will maintain active involvement since the review is part of our consideration of your application.
2. The Service is not fully aware of the extent of the records that will be reviewed. The Service will make every effort to complete the review of your financial operations and activities in a highly expeditious manner. The Service will provide such staffing as it deems necessary to complete the review by the fall of this year, assuming full cooperation from you. In order to ensure that the review is completed as expeditiously as possible, the National Office will work with the Western Region and your representatives actively and regularly to monitor the progress being made.
3. The review may encompass all relevant records of any Scientology organization.
4. You will promptly provide the Service with all requested financial information, including profit and loss statements and balance sheets, for your tax years ending 1984, 1985 and 1986, to be provided at our Los Angeles Key District Office. (#5 is omitted).
6. Both the Service and you agree to cooperate fully at the informal level in an effort to resolve review issues and concerns arising in the review as quickly and expeditiously as possible.
7. After completion of the review, the National Office will notify you if your books of account or records are inadequate, lack internal financial controls, or if any evidence of inurement or other disqualifying activity has been identified.

(AR Ex. VI-17; AR pages VI-122 to VI-123; CST App. 872-873).

143. In a March 17, 1988 memorandum to the IRS Assistant Regional Commissioner (Examination) for the Western Region, the Director of the IRS National Office's Exempt Organizations Technical Division stated as follows:  
Subject: Review of Financial Operations of Religious Technology Center, Church of Spiritual Technology, and Church of Scientology International  
Since 1983 the Exempt Organizations Technical Division has been considering applications for recognition of exemption from the three organizations named above. The applicants were created as part of a reorganization of the Church of Scientology of California and are the uppermost levels of the new Scientology operating structure.  
Pursuant to discussions with members of your staff and the Los Angeles District, we are requesting that the Los Angeles key District conduct a review of the financial operations of each applicant, focusing on the integrity of the accounting systems and on possible inurement, and report their findings to us in writing by the fall of this year. We will use the information they provide, along with other information we have previously obtained, in deciding whether the applicants qualify for recognition of exemption. Because the information will be developed for use in processing the applications for exemption, the reviews will not constitute examinations subject to IRC 7611 nor will they constitute examinations for purposes of any subsequent examinations of the same tax years. The attached letters set out the scope of the reviews and acknowledge that each of the organizations will cooperate in the reviews. These letters have been mailed and signed copies will be forwarded to key District as soon as they are returned to us.  
Although we believe that private inurement is the principal issue to be addressed, we recognize that other issues may present themselves during the course of the reviews. We leave it to the key District's judgment to decide how best to conduct the reviews so as to satisfy itself about the integrity of each organization's financial operations.

While the reviews are in progress, we ask the key District to advise us of any findings they think are significant or

unusual. For this purpose, or to discuss any other matters related to these three organizations, the key District Office may contact Marvin Friedlander at FTS 566-4756.

We are sending a memorandum and financial statements to the District Director, Los Angeles, which will familiarize him with each applicant's operations and our prior action on its application.

Sylvia Burroughs, Examination Division, Los Angeles District, is coordinating an examination involving the Church of Scientology of California for years 1975 through 1980. The agents conducting the financial reviews may wish to contact her to obtain a better understanding of the accounting issues underlying these cases. They may also wish to have a briefing by those individuals in the National Office who have been involved in these cases.

Finally, Scientology's accountants, Grant Thornton (formerly Alexander Grant), are prepared to assist the examinations in any way possible, including making available work papers they used in preparing financial statements.

We understand that a preliminary meeting has been scheduled with Thomas C. Spring, power of attorney. Future-meetings may be arranged by contacting him directly at (202) 778-1168.

(AR Part VII Addendum, pages 244-245; CST App. 1321-1322).

144. The Los Angeles District office began its review of CST's 1986 financial records on March 23, 1988. Initially, two senior IRS Agents, Carl Corsi and Mel Young, and two IRS junior agents were assigned to work on the review full time. After eight weeks, four more full-time agents were added to the review. The reviewing agents were managed by Ray Jucksch, a Group Manager in Los Angeles, and supervised by Mel Joseph, a Branch Chief from Seattle. (Comp., Ans. q 97; AR Ex. VI-30; AR pages VI-167 to VII-168; CST App. 907-908; AR Ex. VII-562; CST App. 920-921)..

145. Each day during its review, CST provided the reviewing agents unlimited access to 18 boxes of its financial records for its fiscal year ending April 30, 1987. These records included CST's bank statements, cancelled checks, disbursement vouchers, invoices, receipts, telephone bills, internal audits, payroll records and staff disbursements accountings for the entire year. (Comp., Ans. q 98; AR Ex. VI-30; AR pages VI-167 to VI-168; CST App. 907-908).

146. The agents also personally inspected CST's preservation facility in California and archival repository in New Mexico. At each inspection, CST's most senior officials accompanied the agents to answer their questions. (Comp., Ans. g 99; AR Ex. VI-30; AR page VI-167; CST App. 907).

147. During the course of the review, the agents issued 65 written document requests asking CST more than 400 very detailed questions. In response, CST provided the agents approximately 240 pages of narrative answers and more than 9,000 pages of exhibits, schedules and supporting documentation. (AR Part VII). CST estimated that the review took almost 3,000 hours of staff time to prepare the responses the agents requested and cost CST about \$250,000 in legal and accounting fees. (AR Ex. VI-30; AR page VI-167; CST App. 907).

148. The agents required CST to substantiate numerous trivial • expenditures, including travel expenses of less than \$5.00 (AR Part VII Addendum, pages 2417, 2418, 2423, 2424, 2430-2432, 2929, 2931-2933; CST App. 1310-1320) and charges over \$1.00 on two of its monthly telephone statements. (AR Ex. VII-647; CST App. 11311132). The agents asked CST to "describe the rationale" for reporting expenditures for "paper towels" and "Galley supplies" in a disbursement account designated "repairs"(AR Ex. VII-912; CST App. 1306). They also asked CST to "fully describe" the galley and bathrooms at one of its facilities. (AR Ex. VII-892; CST App. 1297). Despite the level of detail demanded, CST responded fully to all these requests. (See AR Ex. VII-659; CST App. 1142-1143; AR Ex. VII-893; CST App. 1298-1300; AR Ex. VII-913; CST App. 13071309; AR Part VII Addendum, pages 2417, 2418, 2423, 2424, 24302432, 2929, 2931-2933; CST App. 1310-1320; AR Part VII).

149. In an undated internal memorandum regarding CST, contained in the on-site review materials, the IRS stated:

### 3. Competition with Commercial Enterprises

Scientology "auditing" and "training" activities are religious practices and, therefore, are not in competition with commercial endeavors. However, selling books and E-Meters is an activity which may be conducted for a commercial

purpose.

#### 4. Aggressive Commercial Practices a. Initial Adverse Ruling

Discounts, commissions, and advertising techniques similar to commercial enterprises were noted in the initial adverse ruling.

#### b. Rebuttal

The discounts were explained as incentive programs to encourage increased use of services.

The commissions, 10 percent of the fees received for sending individuals to higher level organizations, paid to independent ministers and Scientology organizations, were explained as a method to prevent the retardation of individuals, religious growth. The advertising aimed at the general public through television and print has been largely done to promote the book Dianetics, since it is represented to be the most effective means of interesting individuals in Scientology. It was pointed out that discounts and advertising are used by major exempt organizations such as the National Geographic Society and public radio and television.

#### c. Conclusion

This would seem to be a draw. So-called commercial practices can be pejorative, depending on one's point of view.

#### 5. Volunteers

Scientology does make extensive use of individuals who work for subsistence, which is a favorable factor distinguishing this organization from commercial endeavors.

#### 6. Private Benefit

After the death of L. Ron Hubbard, this element ceased.  
(AR Part VII Addendum, page 1608; CST App. 1323).

150. On May 23, 1988 and June 2, 1988, the branch chief supervising the review informed CST that his agents had completed their review of CST and were ready to begin their review of RTC.

On these dates, the branch chief informed CST of the results of the IRS review, stating that all documents requested were "ultimately found," that his agents "have not found substantial money going to any one individual" nor "anything that shows inurement," that they could "pin down receipts and expenditures" and that "as to CST, we have no concerns at this-time." (AR Ex. VI-30; AR page VI-168; CST App. 908).

151. The agents began their review of RTC's 1986 financial records on June 2, 1988. (AR Ex. VI-30; AR page VI-167; CST App. 907). On June 21, 1988, the IRS Group Manager, Ray Jucksch, informed Applicants' representatives that the District had finished its review of RTC with no issue of inurement or lack of financial integrity and was ready to begin its review of CSI. (AR Ex. VI-19; AR page VI-132; CST App. 882).

### I. The Aznaran Summons And Interview

152. On June 22, 1988, CST and the other applicants learned that Vicki Aznaran, a 'former officer of RTC, and her husband had been interviewed by IRS agents from Los Angeles. (AR Ex. VI-18, VI-19; AR pages VI-126, VI-127; CST App. 876, 877). The interview was conducted in Dallas, Texas on or about May 20, 1988 by Agents Corsi and Young and by an attorney with the IRS District Counsel Office in Los Angeles. (AR Ex. VI-19; AR page VI-127; CST App. 877). Ms. Aznaran disclosed that the District Counsel attorney, Greg Roth, specifically instructed her that "this meeting is confidential and closed to people outside of this room." (AR Ex. VI-19; AR page VI-130; CST App. 880; AR Ex. VI-21; AR page VI-135; CST App. 885).

153. The interview took place pursuant to summonses agents Corsi and Young had issued on May 9, 1988. (AR Ex. VI-20; AR page VI-134; CST App. 884). Ms. Aznaran's summons was issued "in the matter of Church of Scientology International, Church of Spiritual Technology, and Religious Technology Center" for the "periods 1982, 1983, 1984, 1985, 1986 and 1987." It required her to appear before agents Corsi and Young to testify and produce records with respect to a civil complaint she and her husband had filed on April 1, 1988 against various Scientology organizations and individuals, including CST, CSI and RTC. The summons expressly referred to an attached copy of the complaint.



(AR Ex. VI-20; AR page VI-134; CST App. 884). However, nothing the agents obtained during the Aznaran interview became part of CST's administrative record. (AR Part VII).

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154. Agents Corsi and Young did not attempt to obtain the information they desired about the Aznarans' complaint from CST before they issued the summonses. (AR Ex. VI-29; AR page VI-164; CST App. 904). At no time prior to or after the interview did they, the District Counsel attorney or any of the other agents working on the review give CST the opportunity to comment on the allegations in the complaint, nor did they ever inform the Applicants that they had issued the summonses. (AR Ex. VI-19; AR pages VI-127 to VI-133; CST App. 877-883; AR Ex. VI-29; AR page VI-164; CST App. 904). They also never issued a document request for information concerning lawsuits filed subsequent to the end of CST's 1986 fiscal year on April 30, 1987. (AR Part VII).

155. On many occasions during CST's administrative proceeding, the Service specifically brought to CST's attention past and present litigation involving Scientology organizations and asked CST to discuss their possible relevance to CST or otherwise to comment. (AR Ex. 1-26, 1-27, 1-30 to 1-36, 1-58, 1-60 to 1-66; AR pages 1-218 to 1-219, 1-221 to 1-223, 1-235 to 1-348, 1-453 to 1-466, 1-474 to 1-718). In every instance, CST responded. (AR Ex. Z5. a 1-29, 1-38, 1-69; AR pages 1-232 to 1-233, Moreover, CST devoted an entire section of discussing such litigation, (AR Ex. 11-76, pages 11-517 to 11-524) and also discussed first and second supplemental submissions. pages 111-185 to 111-186; AR Ex. V-534; AR 1-351 to 1-356, 1-725). its protest to pages K-1 to K-8; AR such litigation in its (AR Ex. 111-346; AR pages V-22 to V-24).

156. Throughout the review, agents Corsi and Young purposely concealed the fact that they had issued the summonses to the Aznarans. On May 11, 1988, two days after they issued the summons to Ms. Aznaran, agents Corsi and Young provided RTC with a document request specifically asking RTC to arrange an interview with Ms. Aznaran as one of RTC's 'principal officers.'" (AR Ex. VI-19; AR page VI-132; CST App. 882; AR Ex. VI-22; AR page VI-136; CST App. 886).

157. On June 22, 1988, CST's representatives called the branch chief in charge of the review to ask why agents Corsi and Young had issued the summonses. The branch chief refused to discuss the interview or confirm that it had taken place, and the Applicants informed him that they were "'suspending" the review until they 'resolved the matter with the National Office.'" (Comp. Ans. 1 114; AR Ex. VI-19; AR page VI-128; CST App. 878).

158. CST's representatives also called Mr. Friedlander that day. Mr. Friedlander said he would not discuss the summonses or the interview at that time, and the Applicants informed him that they "'were suspending the review pending resolution of the matter at the National Office.'" (Comp., Ans. q 115; AR Ex. VI-19; AR page VI-128; CST App. 878).

159. On June 23, 1988 Messrs. Owens and Friedlander informed CST that the National office had nothing to add to what the branch chief had said with respect to the summons "because of its confidentiality." (Comp., Ans. \$ 116). Mr. Owens further stated that the National office knew "very little" of what the District was doing and that "this is their activity" (AR Ex. VI-19; AR page VI-129; CST App. 879).

160. By letters dated June 23, 1988, the National Office informed CST and the other two Applicants that it understood their position was that "the agents should obtain information about your organization only through [your representative]; otherwise the March 17th agreement would be terminated." The letter specifically stated that "[u]ntil this matter is settled, we were advised that the review under the agreement is suspended." The National Office demanded notice whether CST wished "to terminate the agreement or continue with the review." (Comp., Ans. q 117; AR Ex. VI-18; AR page VI-126; CST App. 876).

161. On June 24, 1988, CST wrote to the National Office to reiterate the concerns it had expressed, which differed from the National Office's understanding, and to "suggest a solution for resolving what CST viewed as "serious problems" arising from the actions of the District agents. (Comp., Ans. 1 118; AR Ex. VI-19; AR page VI-127; CST App. 877).

162. In the June 24, 1988 letter, CST stated it was concerned "with the manner in which the District agents had obtained the information and subsequently acted, which it believed evidenced bad faith. CST was particularly concerned that the agents neither attempted to obtain the information from CST or the other Applicants before issuing a summons nor gave

them an opportunity to respond to the matters the agents discussed with the Aznarans. CST noted that "the District and National Offices have repeatedly recognized" that the information it had been providing the IRS throughout the proceeding "has been fully responsive to the questions posed." (AR Ex. VI-19; AR pages VI-130 to VI-132; CST App. 880-882).

163. In the June 24, 1988 letter, CST also questioned why the agents had attempted "to cloak their actions in secrecy." CST pointed out that District Counsel attorney Greg Roth expressly instructed Ms. Aznaran that the interview was "confidential and closed to people outside of this room"; that the branch chief refused to acknowledge that the interview had taken place; and that agents Corsi and Young asked RTC to arrange an interview with Ms. Aznaran as one of RTC's "principal officers" two days after they had issued her summons when they were "well aware of the complaint and Ms. Aznaran's relationship to Applicants". (Comp., Ans. q 120; AR Ex. VI-19; AR pages VI-128, VI-130, VI-132; CST App. 878, 880, 882).

164. In the June 24, 1988 letter, CST requested the National Office to meet with it to discuss possible ways to resolve its concerns. (Comp., Ans. j 123; AR Ex. VI-19; AR page VI-133; CST

165. Following receipt of CST's June 24, 1988 letter, Mr. Friedlander called CST representatives and acknowledged the IRS "owed (CST) an explanation" with respect to the matter. (AR Ex. VI-29; AR page VI-164; CST App. 904).

#### J. The IRS's Termination Of the On-Sits Review

166. The National Office refused to grant a meeting as requested in CST's letter of June 24, 1988. The only explanation given to CST was that the National Office would not discuss their concerns. In a letter dated July 7, 1988, the National office informed CST that it believed the National Office and the District had acted in accordance with the Settlement Agreement and that "by removing the records from our agents, we consider that you do not wish to fulfill the terms of the March 17, 1988, agreement" The National Office concluded the letter by stating the IRS would "complete our consideration of your application as expeditiously as possible." (Comp., Ans. 1 125; AR Ex. VI-23; AR page VI-137; CST App. 887).

167. On July 8, 1988, Mr. Friedlander called CST's representatives and informed them that the National Office intended to issue final adverse rulings later that day. He said CST could not supplement its administrative record with any additional facts or legal arguments. (Comp., Ans. 1 126; AR Ex. VI-29; AR page VII63, VI-165; CST App. 903, 905).

168. On July 8, 1988, CST provided the National Office with a written appeal to keep the proceedings open. CST told the National Office that it had no time advised you that [it] did not wish to fulfill the terms of the March 17, 1988 agreement"; that CST sought a meeting "in order to continue with the review, not to terminate it"; that CST was "compelled by the actions of the Los Angeles District Office agents to suspend the review pending resolution of (its) concerns at the National Office;" and that "[i]f the Service declines to meet with [CST] and continue with the review at this time, it is the Service and not [CST] who does not wish to fulfill the terms of the March 17, 1988 agreement." (Comp., Ans. 1 127; AR Ex. VI-29; AR page VI-163; CST App. 903).

169. In its July 8, 1988 letter, CST pointed out that if the concerns expressed by it and the other Applicants were "not well founded, the Service should be willing to meet and so advise Applicants." CST also stated that it was "perplexed as to why the Service would choose to stop these determination proceedings at this time and impose these matters upon a court, particularly in light of the spirit of cooperation we have developed and the substantial progress we have made over the last two years." (Comp., Ans. y 128; AR Ex. VI-29; AR page VI-164; CST App. 904).

170. In its July 8, 1988 letter, CST protested Mr. Friedlander's refusal to permit the Applicants to supplement their administrative records as contrary to long-established IRS procedures. CST pointed out that in the two years since the National Office had issued the initial adverse letter it had submitted concrete and detailed information establishing that the conclusions in the initial letter had been based on fundamental misconceptions of facts. CST further noted that the IRS "has yet to address" the new information furnished by CST. (Comp., Ans. ~[ 129; AR Ex. VI-29; AR pages VI-165 to VI-166; CST App. 905-906).

171. In its July 8, 1988 letter, CST maintained that the < proceedings should stay open as "a matter of fundamental fairness" so it could "submit additional information relevant to any ground on which the Service may base its final determination that differs from those stated in the initial adverse letter." CST also stated that it intended to file a detailed chronology of the concerns that led it to suspend the review and request a meeting with the National Office. (Comp., Ans. q 130; AR Ex. VI-29; AR page VI-166; CST App. 906).

#### E. The Final Adverse Ruling

172. On July 8, 1988 the IRS issued CST a final ruling denying it exemption under Code section 501(c)(3). The IRS issued the ruling exactly one day after it had notified CST that it would complete its consideration of CST's exemption application "as expeditiously as possible." (Comp., Ans. 1 131; AR Ex. VI-23; AR page VI-138; CST App. 888; AR Ex. VI-24; AR pages VI-139 to VI-149; CST App. 889-899).

173. As part of its grounds for its specific determination that CST operated for a substantial non-exempt commercial purpose, the IRS found (1) that CST made Mr. Hubbard's writings available to other Scientology churches in exchange for so-called contributions; (2) that CST benefitted other Scientology churches by furthering "their objective of marketing Scientology products and services" by collecting works that "were being commercially exploited by Mr. Hubbard and some of the organizations licensed by him;" and (3) that CST "embraced" the "marketing efforts" of organizations in the hierarchical church "because the products they market are derived" from the original works that CST collects. (AR Ex. VI-24; AR page VI-144; CST App. 894). None of these findings were included in the initial adverse determination letter issued to CST, (AR Ex. 1-79; AR pages 1-753 to 1-815; CST App. 245-307), nor had these points ever been raised with CST. (Entire Record).

174. By letter dated July 12, 1988 the National Office denied CST's request to supplement its administrative record with a chronology of the concerns that led CST to suspend the review. (Comp., Ans. q 133; AR Ex. VI-31; AR page VI-179; CST App. 919).

175. In a letter dated July 19, 1985 to Senator Jesse A. Helms, former Secretary of the Treasury James A. Baker stated as follows:

Section 501(c)(3) of the Code exempts from federal income taxation any entity that is organized and operated exclusively for religious purposes. As a conscious policy decision, the Code and the applicable Treasury regulations do not attempt further to define what religious purposes are. This decision, which reflects-the First Amendment to the Constitution and its interpretation by the courts, has withstood the test of time.

The Service does not simply accept a claim of religious belief at face value in making determinations under section 501(c)(3). Instead, it makes two inquiries. The first is whether the organization's practices or rituals are illegal or are contrary to clearly defined public policy. The second is whether the asserted beliefs are sincerely held by those professing to follow them.

(AR Ex. 11-76; AR pages 11-545 to 11-546; CST App. 496-497).

Respectfully submitted,

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ATTORNEY FOR PLAINTIFF



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#### 7.1.1. Grants to Exempt Organizations.

The Trustee may make grants or contributions to, or otherwise render financial assistance to, any organization other than Trustee which is organized and operated exclusively for purposes which are the same as or similar to the purposes of the Trust, and which is an organization described in Sec. 501(c)(3) of the Internal Revenue Code, provided only that such grants, contributions, or other financial assistance are utilized solely for accomplishing such purposes.

\* \* \*

#### 8. Limitation Upon Activities of the Trust

In furtherance of the exclusively charitable, educational and religious purposes of the trust, and to the end that the trust may be operated exclusively for such purposes, the Trust shall not be operated for the benefit of any private person, no part of the net earnings of the Trust shall inure to the benefit of any private individual either directly or indirectly; no substantial part of the activities of the Trust shall in any way consist in the carrying on of propaganda or otherwise attempting to influence legislation; and the Trust shall neither directly nor indirectly participate in or intervene in any political campaign on behalf of or in opposition to any candidate for public office, including the publishing and distribution of statements.

\* \* \*

#### 10.3 Distribution of the Trust Assets Upon Termination

Upon termination of the trust, all assets of the Trust, including both undistributed portions of the corpus thereof and all net income therefrom, whether accumulated or otherwise undistributed, shall be distributed among one or more organizations, other than the trustee, which are described in Section 501(c)(3) of the Internal Revenue Code and which are organized and operated exclusively for purposes which are the same as or similar to the purposes of the Trust..