

RUTGERS JOURNAL OF LAW & RELIGION

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THE ECONOMICS OF SECTION 170: A CASE FOR THE CHARITABLE DEDUCTION OF PAROCHIAL SCHOOL TUITION

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TABLE OF CONTENTS

I. Introduction.....	225
II. Policy Justifications for Charitable Deductions as Applied to Tuition Payments for Parochial Education	232
III. Legal Background: American Bar, Hernandez, and Sklar.....	242
IV. Defining the Market: The Costs and Benefits of Religious Jewish Education	255
V. Subsidy Theory and the Policy Implications of Permitting Tuition Deductions	272
VI. Conclusion	276

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ABSTRACT

That payments for parochial school tuition are not deductible under Section 170 of the Internal Revenue Code is a foregone conclusion in the eyes of many tax policy scholars. Tuition provides an easy case because the donor receives something of great value in return for his donation: the education of his children. This Article questions that conclusion. By taking a close look at the economics behind these tuition payments in the context of a discrete population, the religious Jewish community, I show that traditional economic assumptions are inappropriate for analysis of those payments. Rather than a traditional economic exchange for economically valuable services, tuition payments should be characterized as payments made for unique and vital religious services—payments in exchange for an intangible religious benefit. The benefit of education, so characterized, is not different from many other intangible religious benefits for which corresponding payments are fully deductible. With that observation, I apply traditional tax policy analysis and the policy justifications for Section 170 to payments for parochial school tuition and present an argument for the deduction of tuition payments.

I. INTRODUCTION

The policy justifications for Section 170 of the Internal Revenue Code¹—authorizing deductions from income, for income tax purposes, equal to the amount of charitable contributions in a given tax year—have long been debated. First codified in the War Revenue Act of 1917,² Section 170 has a limited legislative history, leaving policy-

¹ 26 U.S.C. § 170 [hereinafter “Section 170”].

² *Bob Jones Univ. v. United States*, 461 U.S. 574, 588 n.10 (1983); J.S. SEIDMAN, SEIDMAN’S LEGISLATIVE HISTORY OF FEDERAL INCOME TAX LAWS 1938-1861 944-45 (1938); Mark P. Gergen, *The Case for a Charitable Contributions Deduction*, 74 VA. L. REV. 1393, 1393 n.1 (1988). The statute, as codified in 1917 read:

Contributions or gifts actually made within the year to corporations or associations organized and operated exclusively for religious, charitable, scientific, or educational purposes, or to societies for the prevention of cruelty to children or animals, . . . [are deductible up] to an amount not in excess of fifteen per centum of the

makers interpreting Section 170 with little guidance. The predecessor to Section 170 was added to the War Revenue bill of 1917 during Senate debates, but without comment on the propriety of or theoretical justification for tax deductions for charitable contributions. Moreover, there is nothing in the legislative history that indicates why certain donee organizations ought to be entitled to tax deductible contributions while other organizations are to be excluded.³

Legal sources that define charity and set forth a list of charitable organizations are, however, quite old.⁴ The Charitable Uses Act 1601 (written two years before the death of Queen Elizabeth I) provides in its preamble a non-exclusive list of charitable uses, which includes the “repair of . . . churches.”⁵ As early as 1639, an English court held that

taxpayer’s taxable net income as computed without the benefit of this paragraph.

War Revenue Act of 1917, § 1201(2), Pub. L. No. 65-50, 40 Stat. 300. The 1917 definition of charitable donations is remarkably similar to the modern version, codified in Section 170 subsection (c):

[T]he term ‘charitable contribution’ means a contribution or gift to or for the use of . . . (2) A corporation, trust, or community chest, fund, or foundation . . . (B) organized and operated exclusively for religious, charitable, scientific, literary, or educational purposes, or to foster national or international amateur sports competition . . . , or for the prevention of cruelty to children or animals . . .

³ See 55 CONG. REC. 6728 (1917).

⁴ See Herman T. Reiling, *What is a Charitable Organization?*, 44 A.B.A. J. 525, 526 (1958) (authored by the Assistant Chief Counsel of the Internal Revenue Service) (“‘Charity’ in the legal sense, which includes *inter alia* the advancement of religion . . . has a generally accepted meaning that is supported by a long line of British and American court decisions extending back to 1601.”).

⁵ Statute of Elizabeth 1601, 43, c. 4 (Eng.); see also Fiona Martin, *Charities for the Benefit of Employees: Why Trusts for the Benefit of Employees Fail the Public Benefit Test*, 5 eJOURNAL TAX RES. 59, 60-61 (2007). The relevant portion of the preamble reads (archaic spelling and capitalization preserved):

Whereas Landes Tenement Rentes Annuities P[ro]fittes Hereditamentes, Goodes Chattels Money and Stockes of Money, have bene heretofore given limited appointed and assigned, as well by the Queenes moste excellent

money given to maintain a preaching minister was a charitable use.⁶ The earliest articulation of such a list in the United States, as far as I am aware, was made by Justice Gray⁷ in 1867 while sitting on Massachusetts's high court:

A charity, in the legal sense, may be more fully defined as a gift, to be applied consistently with existing laws, for the benefit of an indefinite number of persons, either by *bringing their minds or hearts under the influence of education or religion*, by relieving their bodies from disease, suffering or constraint, by assisting them to establish themselves in life, or by erecting or maintaining public buildings or works or otherwise lessening the burdens of government.⁸

Majestie and her moste noble Progenitors, as by sondrie other well disposed psons, some for Releife of aged impotent and poore people, some for Maintenance of sicke and maymed Souldiers and Marriners, Schools of Learninge, . . . some for *Repaire of Bridges Portes Havens Causwaies Churches Seabankes and Highewaies* . . . Whiche Landes Tenements Rents Annuities P[ro]fitts Hereditaments Goodes Chattells Money and Stockes of Money nevtheles have not byn employed accordinge to the *charitable intente* of the givers and founders thereof . . . Be it enacted . . . [that such charitable uses] may be duelie and faithfullie employed, to and for suche of the *charitable uses and intents* before rehearsed respectivelie

Statute of Elizabeth 1601, 43, c. 4 (Eng.) (emphasis added).

⁶ Pember v. Inhabitants of Knighton, Duke 82 (1639); AUSTIN W. SCOTT, SELECT CASES AND OTHER AUTHORITIES ON THE LAW OF TRUSTS 317 (1919) (summarizing *Pember*); see also John W. Curran, *Trust for Masses*, 7 NOTRE DAME L. REV. 42, 42 (1932); John W. Whitehead, *Tax Exemption and Churches: A Historical and Constitutional Analysis*, 22 CUMB. L. REV. 521, 533-35 (1992).

⁷ Horace Gray served as Associate Justice of the Supreme Court of the United States from 1882 until 1902. He was the author of *United States v. Wong Kim Ark*, 169 U.S. 649 (1898) (ruling that a child born to foreign nationals while in United States territory is, under certain conditions, a citizen of the United States).

⁸ *Jackson v. Phillips*, 96 Mass. (14 Allen) 539, 556 (Mass. 1867) (emphasis added).

A 19th century English case known as *Commissioners for Special Purposes of Income Tax v. Pemsel*, in a writing that has become canonical in the United States,⁹ found that the legal term “charity” is not defined by its popular meaning but by the law of charitable trusts, which comprises “four principal divisions: . . . relief of poverty, . . . advancement of education, . . . advancement of religion, . . . [and] other purposes beneficial to the community [at large].”¹⁰ The Restatement (Second) of Trusts retains these four categories of charitable trusts and adds two more, public health and governmental purposes.¹¹ The list delineated by *Pemsel* and repeated by the Restatement closely mirrors the one adopted by Congress in 1917 in its first articulation of what is today Section 170: “corporations or associations organized and operated . . . for religious, charitable, scientific, or educational purposes, or to societies for the prevention of cruelty to children or animals.”¹²

Interestingly, *Pemsel* and other early authorities on the definition of charity make no attempt to explain the source of their lists. *Pemsel* is particularly curious because it cited the law of trusts as definitive and then neglected to trace the relevant history or otherwise describe how the law of trusts came to be so defined. Presumably, the absence of clearer guidance on the proper delineation of the list of charitable organizations is partially to blame for the considerable

⁹ See, e.g., *Evans v. Newton*, 382 U.S. 296, 307 (1966); *Bob Jones Univ.*, 461 U.S. at 589; *Martin*, *supra* note 5, at 61 (“The classification of charitable purpose into these four areas was seen as a milestone and has been consistently used in judicial considerations ever since.”); *Reiling*, *supra* note 4, at 527.

¹⁰ *Commissioners for Special Purposes of Income Tax v. Pemsel*, [1891] A.C. 531, 583 (H.L.) (appeal taken from Eng.) (opinion of Lord Macnaghten).

¹¹ RESTATEMENT (SECOND) OF TRUSTS § 368 (1959).

¹² See War Revenue Act of 1917, *supra* note 2.

controversy¹³ surrounding Section 170 charitable deductions and, particularly in the context of religious organizations, considerable litigation.¹⁴

Without a clear indication as to how religious organizations gained the title “charitable,” it is unclear if and under what circumstances religious organizations ought to be denied the right to accept deductible charitable contributions. Based on the broad language of Section 170 and a Treasury Regulation under Section 501,¹⁵ it appears that religious organizations are presumed “charitable,” regardless of whether or not they are furthering purely philanthropic ends (such as the operation of a soup kitchen). Indeed, the “*advancement of religion*” appears to be a bona fide “charitable” objective.¹⁶ As Herman Reiling wrote while serving as Assistant Chief Counsel to the Internal Revenue Service, the presumption that religious

¹³ E.g., William D. Andrews, *Personal Deductions in an Ideal Income Tax*, 86 HARV. L. REV. 309 (1972); Mark G. Kelman, *Personal Deductions Revisited: Why They Fit Poorly in an “Ideal” Income Tax and Why They Fit Worse in a Far from Ideal World*, 31 STAN. L. REV. 831 (1979); Gergen, *supra* note 2; Jeffrey H. Kahn, *Personal Deductions—A Tax “Ideal” or Just Another “Deal”?*, 2002 L. REV. M.S.U.-D.C.L. 1.

¹⁴ See generally *Bob Jones Univ.*, 461 U.S. at 574 (1983); *Hernandez v. Comm’r*, 490 U.S. 680 (1989); *Sklar v. Comm’r*, 282 F.3d 610 (9th Cir. 2002) [hereinafter “*Sklar I*”]; *Sklar v. Comm’r*, 549 F.3d 1252 (9th Cir. 2008) [hereinafter “*Sklar II*”]; see also *Oppewal v. Comm’r*, 468 F.2d 1000 (1st Cir. 1972); *Winters v. Comm’r*, 468 F.2d 778 (2d Cir. 1972); *DeJong v. Comm’r*, 309 F.2d 373 (9th Cir. 1962). *Oppewal*, *Winters*, and *DeJong* stand for the proposition that tuition is not deductible in the First, Second, and Ninth Circuits respectively. While an analysis of these cases is beyond the scope of this paper, I note that at least one recent article articulates a cogent argument that they are no longer binding. Douglas A. Kahn & Jeffrey H. Kahn, ‘*Gifts, Gifts, and Gifts—The Income Tax Definition and Treatment of Private and Charitable ‘Gifts’ and a Principled Policy Justification for the Exclusion of Gifts from Income*, 78 NOTRE DAME L. REV. 441, 512-15 (2003).

¹⁵ Treas. Reg. § 1.501(c)(3)-1(d)(2) (1958) (as amended in 2008).

¹⁶ This formulation, articulated in *Pemsel*, *supra* note 10 and accompanying text, has been preserved in the Regulations defining tax exemption under Section 501, which provide that the term “charitable” is used in its “generally accepted legal sense” and includes the “advancement of religion.” Treas. Reg. § 1.501(c)(3)-1(d)(2).

organizations “serve[] a public interest . . . springs from the fact that the advancement of religion is generally recognized as fundamental to our way of life.”¹⁷ It follows that Section 170 embodies a congressional policy of advancing religious interests.

This congressional policy was tested in *Hernandez v. Commissioner* as the Supreme Court ruled in 1989 that payments for certain intangible religious benefits offered by the Church of Scientology were not tax deductible.¹⁸ In a strongly worded dissent, Justice O’Connor, joined by Justice Scalia, argued that the majority unconstitutionally denied Scientology the benefits of certain prior IRS rulings to religious organizations.¹⁹ Indeed, in 1970 (nearly twenty years before *Hernandez*) the IRS formalized its long-standing policy of permitting deductions for religious *quid pro quo* transactions—transactions in which the donor receives an intangible religious benefit in exchange for his donation. Revenue Ruling 70-47 states that “[p]ew rents, building fund assessments, and periodic dues paid to a church [as defined by Section 170(c)] are all . . . deductible as charitable contributions.”²⁰ The policy of allowing deductions for religious *quid pro quo* transactions is not new; it arguably has precedent dating back to 1919, two years after the enactment of the predecessor to Section 170.²¹ As Part II will show, the donations in *Hernandez* are materially indistinguishable from others long-permitted by the IRS.

In dicta, Justice O’Connor attempted to distinguish the donations in *Hernandez* from tuition payments for religious schools, concluding

¹⁷ Reiling, *supra* note 4, at 595.

¹⁸ *Hernandez*, 490 U.S. at 687-89. The basis for the majority holding is discussed *infra* Part II.

¹⁹ *Id.* at 704 (O’Connor, J., dissenting).

²⁰ Rev. Rul. 70-47, 1970-1 C.B. 49.

²¹ *Hernandez*, 490 U.S. at 707 (O’Connor, J., dissenting).

that tuition is not deductible up to the market value of the “secularly useful education received.”²² Thus, for the entire *Hernandez* Court, parochial school tuition presented an easy case for the disallowance of a charitable deduction. The Court is not alone; many commentators have long seen such payments as *quid pro quo* transactions in exchange for education, and thus non-deductible economic exchanges.²³ As this Article will demonstrate, Justice O’Connor’s comment in *Hernandez* rests on certain assumptions that need close analysis. Part I considers policy justifications for permitting Section 170 charitable deductions for tuition payments to religious institutions. Part II takes a closer look at the *Hernandez* decision and introduces the *Sklar* litigation, which specifically addressed the question of deductibility for religious Jewish school tuition payments. Adopting *Sklar* as a paradigm, Part III will consider the costs and benefits of tuition payments for parents in the Jewish religious school market and will argue that this market is not comparable to other educational markets. Part IV will then reconsider the policy and economic justifications for Section 170, and explore how they ought to operate given the nature of the economic realities facing Jewish religious schools.

²² Justice O’Connor further stated:

It must be emphasized that the IRS’ position here is not based upon the contention that a portion of the knowledge received from auditing or training is of secular . . . value. Thus, the denial of a deduction in these cases bears no resemblance to the denial of a deduction for religious-school tuition up to the market value of the secularly useful education received.

Hernandez, 490 U.S. at 705 (O’Connor, J., dissenting) (emphasis removed).

²³ See, e.g., Allan J. Samansky, *Deductibility of Contributions to Religious Institutions*, 24 VA. TAX REV. 65, 70 (2004); Kahn & Kahn, *supra* note 14, at 508-09 (“The benefit that the taxpayers received (the education of their children) was a service regularly purchased on the commercial market, and therefore easily valued.”).

II. POLICY JUSTIFICATIONS FOR CHARITABLE DEDUCTIONS AS APPLIED TO TUITION PAYMENTS FOR PAROCHIAL EDUCATION

As noted above,²⁴ there is little legislative history to guide our understanding of Section 170 and its proper application in close cases. The original version of Section 170 was introduced by Senator Henry F. Hollis during Senate debates over the Revenue War Act of 1917.²⁵ In support of his amendment, Senator Hollis offered some comments about his proposal and submitted six newspaper editorials dated from June 29, 1917 through August 25, 1917, which were reprinted in the Congressional Record. The comments of Senator Hollis and these six editorials appear to be the entire legislative history as of 1917. Senator Hollis noted:

Usually people contribute to charities . . . out of their surplus. After they have done everything else they want to . . . then, if they have something left over, they will contribute it to a college or to the Red Cross or for some scientific purposes. Now, when war comes and we impose these very heavy taxes on incomes, that will be the first place where the wealthy men will be tempted to economize.²⁶

It appears that Senator Hollis wanted to subsidize selected sectors for fear that they would not be able to obtain sufficient capital after the assessment of new taxes during World War I because most of their

²⁴ *Supra* text accompanying notes 2-16.

²⁵ 55 CONG. REC. 6728 (1917). Hollis' amendment inspired virtually no floor debate. *See* SEIDMAN, *supra* note 2.

²⁶ 55 CONG. REC. 6728 (1917).

revenue came from private donations. His focus seemed to be on the continued financial success of these institutions, rather than on the plight of philanthropists suffering under excessive taxation. Similarly, the promotion of charitable institutions, rather than the protection of philanthropists, was the primary focus of three of his six editorials (and an argument present in two of the remaining three). One of those three editorials is particularly explicit:

The primary purpose of the amendments is, of course, to *safeguard* the continuance of the valuable public work of educational, charitable, and religious institutions in this hour of need and to *enable them to meet the new demands* the war will make on them. Only *secondarily* do they consider the incidental effect of the deductions and exemptions upon the donors or contributors whose generosity and public service they so justly recognize.²⁷

Three of the editorials explicitly discuss competing policy justifications, referring to the “penalty” that the new tax burdens, in the absence of charitable deductions, would impose on philanthropists. This was made explicit in the title to one of those articles: *Do Not Penalize Generosity*.²⁸ Another, titled *Conscription of Income*,²⁹ argued that just as the government must be careful not to conscript men whose civilian labor is vital to the war effort or on whom families are dependent for support, it should be careful not to conscript income that is better devoted to funding public charities, fulfilling an important

²⁷ *Id.* at 6729 (citing *Popularizing Tax Burdens*, WASH. POST, Aug. 1, 1917) (emphasis added).

²⁸ *Id.* at 6729.

²⁹ *Id.*

public need.³⁰ The latter arguments, while not mutually exclusive with the policy of promoting charitable donations, are not directly related to such promotion. While the tenor of the discussion suggested that promotion was the overriding theory, the legislative history in 1917 is, at best, inconclusive regarding the theoretical justification behind Section 170.

Diversity in thought regarding the policy justifications underlying Section 170 expanded significantly following a 1972 article by Professor William Andrews. Andrews famously hypothesized that the theoretical justification for Section 170 is derived not from its legislative history, but from its ability to properly exclude money given to charity—from which the donor gets no personal benefit—from the donor's income because that income is not allocable to consumption.³¹ The criticism and commentary on his work and other works motivated by it resulted in the rapid development of a stunning variety of contradictory theoretical justifications for charitable deductions.³² Rather than trying to prove that any one theory is “correct,” this Article will demonstrate that the subsidy theory is particularly well supported in historical and legal texts, and will adopt it as a tool for analyzing charitable donations to religious organizations in particular.

Subsidy theory posits that relevant tax law is designed to subsidize certain socially desirable public organizations by encouraging private donations. It is thus closely related to Senator Hollis' desire to “safeguard the continuance of the valuable public work of educational,

³⁰ *Id.* Permitting these charities to continue their service, the author claimed, “eventually will save the Government much more [money].” *Id.*

³¹ *See generally* Andrews, *supra* note 13.

³² *See, e.g.,* Kelman, *supra* note 13; Samansky, *supra* note 23, at 75.

charitable, and religious institutions.”³³ Rather than allocating funds directly from the federal treasury to facilitate the function of certain public organizations, the tax laws forgo certain revenue to encourage private donation to public charities. The net result is the same (subject to the discussion below regarding possible allocational inefficiencies³⁴): the federal treasury has less money and the targeted public organizations have more. Equivalence between direct subsidization through appropriation and indirect subsidization through the tax system is not simply accidental under this theory, it is the very goal of the charitable deduction.

While my objective is not to demonstrate the correctness of subsidy theory, it has considerable support that bears mention. Indeed, one recent commentary declared without reservation, that “[t]he congressional purpose for allowing . . . a deduction is to encourage the infusion of private funds into the public sector.”³⁵

First, subsidy theory suggests an explanation for otherwise curious aspects of Section 170. For example, Section 170 permits holders of certain appreciated capital gain property to deduct the entire fair market value of the property despite having never paid tax on anything above the cost basis of that property.³⁶ Even the Committee on Ways and Means has remarked that this provision lacks normative justification.³⁷ Subsidy theory makes this provision more understandable because it tends to stimulate donations of certain tangible property to

³³ See 55 CONG. REC. 6728, *supra* note 25.

³⁴ *Infra* text accompanying notes 42-44.

³⁵ Kahn & Kahn, *supra* note 14, at 513-14.

³⁶ I.R.C. § 170(e)(1)(A) (2000).

³⁷ H.R. REP. NO. 75-1860, report by the Committee on Ways and Means on the Revenue Bill of 1938, at 20 (1938).

organizations that can make good use³⁸ of that property.³⁹ Additionally, subsidy theory may provide some normative justification for the so-called “upside-down problem” (the observation that deductions are worth more to the wealthy due to their higher marginal tax rates). Because the wealthy are best able to subsidize charitable organizations, it is efficient to concentrate resources on stimulating donations by the wealthy by offering a tax deduction, rather than a tax credit.

Second, subsidy theory seems to be more responsive to the limited legislative history provided by Senator Hollis.⁴⁰ Perhaps, as the remainder of this paragraph explains, subsidy theory underlies the “conscriptio of income” argument articulated in the sixth editorial included by Senator Hollis in the Congressional Record of 1917.⁴¹ One study found that the dollar amount transferred from the private sector to public charities exceeds revenue losses by as much as two dollars for every one, thus demonstrating that the charitable deduction actually functions to increase collective wealth.⁴² While other studies show the subsidy to be less efficient than a two-to-one return, they fairly consistently demonstrate net positive returns from charitable

³⁸ In truth, the recipient is more likely to sell the property than actually put it back into service. The net result, however, is the same. The former owner is able to put the appreciation of the property to a good use in a manner that would have been considerably less efficient—and therefore might not have happened—but-for the tax subsidy.

³⁹ If the goal of Section 170 is to increase charitable donations, encouraging holders of appreciated capital gain property to give their property to charities that might be able to use the property more efficiently appears to be an effective means of reaching the desired ends of Section 170. Kahn & Kahn, *supra* note 14, at 514 n.341. This is particularly true in the case of highly appreciated property because the property holder is likely to resist selling that property (even where sale might be economically efficient) to avoid high tax liability.

⁴⁰ Subsidy theory is implicated in his own testimony as well as five of the six editorials Senator Hollis submitted for publication in the Congressional Record. *See supra* notes 24-30 and accompanying text.

⁴¹ *See supra* text accompanying notes 29-30.

⁴² Gergen, *supra* note 2, at 1404.

subsidization.⁴³ Thus, if the charitable deduction hypothetically costs the treasury \$30 billion, this forfeited revenue accounts for a transfer of *more* than \$30 billion, and possibly as much as \$60 billion, to public charities. From the public's prospective, charitable subsidy seems highly desirable if we assume that such donations are made in accord with the aggregate public interest. Alternatively, even if we presume that charitable allocations are not entirely equitably beneficial, subsidy by the private sector may be more efficient than direct government financing once we account for all of the red tape associated with government operations and the legal restrictions imposed on government, such as those imposed by modern Establishment Clause jurisprudence.⁴⁴ If the private sector is better equipped than the government to efficiently finance public charities, it should follow that efficient taxation requires that funds which would be set aside for donation be left un-"conscripted" by the tax system to permit efficient subsidization.

Third, there is basis for the argument that legislative history supports the subsidy theory. A 1938 report by the Committee on Ways and Means articulated the rationale for the charitable deduction, apparently adopting the policy of subsidization. The Committee wrote:

The exemption from taxation of money or property devoted to charitable and other purposes is based upon the theory that the Government is compensated for the loss of revenue by its relief from financial burden which would otherwise have to be met by appropriations from public funds, and by the

⁴³ *Id.*

⁴⁴ *Infra* text accompanying notes 52-54.

benefits resulting from the promotion of the general welfare.⁴⁵

The Committee made an efficiency argument (it costs the government less to finance the charitable sector via the tax code than through direct disbursements). Underlying its efficiency argument is an assumption that the government has some obligation—legal, moral, or otherwise—to support the charitable sector. The use of the tax system as a vehicle for the support of the charitable sector is the essence of subsidy theory. Thus, even if subsidization was not central to the 1917 legislation, subsidy theory was adopted by the House Committee on Ways and Means in its report on the Revenue Act of 1938. Arguably, subsidization became part of the congressional intent behind Section 170 through the 1938 enactment and subsequent reenactments of the tax laws.

Finally, the Supreme Court seems to have subscribed to subsidy theory. For example, in 1983, Justice Rehnquist, writing for a unanimous Court, described the theory behind the charitable deduction: “[T]ax deductibility [is] a form of subsidy that is administered through the tax system Deductible contributions are similar to cash grants of the amount of a portion of the individual’s contributions. The system Congress has enacted provides this kind of subsidy to nonprofit civic welfare organizations generally”⁴⁶

Some, including Professors Gergen and Samansky, have argued that the subsidy argument actually provides poor theoretical justification for deductions for donations to religious charitable

⁴⁵ H.R. REP. NO. 75-1860, report by the Committee on Ways and Means on the Revenue Bill of 1938, at 19 (1938).

⁴⁶ *Regan v. Taxation with Representation of Washington*, 461 U.S. 540, 544 (1983).

institutions. The subsidy argument works only if we assume that donations to public charities happen only but-for the subsidy. If donations to religious organizations would occur independent of the existence of a charitable deduction, that deduction is not rightly deemed a “subsidy.” These commentators generally argue that the current donors to religious institutions would likely remain donors because they tend to benefit directly from their donations.⁴⁷ As one commentary snidely put it: “[O]ne might speculate that the primary motive for giving to religion is for the donor to provide himself a spiritual clubhouse.”⁴⁸ In theory, donors who receive a personal benefit would be likely to continue to pay for that benefit up to the extent of its value to that donor. The fact that parochial school tuition payments occur despite the absence of any deduction is irrefutable proof, they say, that subsidy is unnecessary. Indeed, the fact that tuition payments are made in the absence of a subsidy should not be surprising. “Religious education is the sort of thing we would expect parents and church members to provide on their own. Parents have a strong interest in the moral education of their children.”⁴⁹ As Part III of this Article argues, their observation proves far too much and that the fact that the transactions continue under present conditions actually demonstrates charitable intent. For now, I will respond simply by saying that subsidy theory does not rest on the assumption that deductions are necessary to prevent charitable activity from *ceasing*. If it were, a great deal more

⁴⁷ Samansky, *supra* note 23, at 77; Gergen, *supra* note 2, at 1434 (“Churches obtain over four-fifths of their income from members, mostly [in] small contributions, and over four-fifths of church income goes to operations and current expenses.”).

⁴⁸ Mark A. Hall & John D. Columbo, *The Donative Theory of the Charitable Tax Exemption*, 52 OHIO ST. L.J. 1379, 1401 (1991) (citing David B. Johnson, *The Charity Market: Theory and Practice*, in *THE ECONOMICS OF CHARITY* 92-93 (1973)).

⁴⁹ Gergen, *supra* note 2, at 1437.

empirical evidence would have been necessary to compile the list of charitable organizations in Section 170 and the four types of charitable trusts, including trusts dedicated to the advancement of religion, articulated by the House of Lords in 1891.⁵⁰ Rather, subsidization implies improvement. The advancement of religion is furthered, tautologically, when religion is advanced, not only when it is permitted to hobble on crutches provided by the generosity of the government speaking through Section 170. Said differently, the charitable intent of the giver is not dependent on his belief that his gift is necessary for the survival of the institution to which he gives. Donations to religious organizations do not cease to be charitable simply because the donor receives some intangible religious benefit, because the donor has a personal incentive to fund a transaction absent government subsidy, or because the donor would have given his donation but for the subsidy provided by the government through its tax laws.

In truth, subsidy theory has particular appeal in the context of religion. To the extent that we see religious organizations as benefiting the public good and their funding and support in our mutual interest (as is presumably an underlying assumption of Section 170⁵¹), the Constitution (as presently understood) virtually requires that we adopt some method of incentivizing private funding should we wish to pursue this mutual interest. The Establishment Clause of the First Amendment⁵² permits the direct funding of religious organizations by the government in only limited circumstances, the specific contours

⁵⁰ See *supra* text accompanying note 10.

⁵¹ See *supra* text accompanying notes 15-16.

⁵² “Congress shall make no law respecting an establishment of religion” U.S. CONST. amend I.

and applications of which are beyond the scope of this Article.⁵³ In brief, it generally permits direct funding except regarding the actual diversion of government funds for strictly religious purposes.⁵⁴ Accordingly, governments that wish to support the advancement of religion, a *bona fide* charitable endeavor,⁵⁵ must resort to indirect funding mechanisms that have a principal secular purpose.⁵⁶ (The Supreme Court has upheld on these grounds a state tax deduction that permitted parents to deduct the costs of parochial school tuition.⁵⁷) Tax deductions that incentivize private transactions with charitable institutions present one such permissible form of indirect aid; they may be the most effective way that the government can properly—using “neutral, secular criteria that neither favor nor disfavor religion”⁵⁸—support the public’s advancement of religion.⁵⁹

The policy objectives of Section 170 provide something of a normative requirement to interpret Section 170 broadly, to the extent that the Constitution allows, in a manner that permits deductions for

⁵³ Current law was essentially written by Justice O’Connor in her concurrence in *Mitchell v. Helms*, 530 U.S. 793 (2000). *Mitchell* received no majority decision and Justice O’Connor’s concurrence, which was joined by Justice Breyer, rests on the “narrowest grounds” and is thus controlling. *Columbia Union College v. Oliver*, 254 F.3d 496, 502-04 & n.1 (4th Cir. 2001) (quoting *Marks v. United States*, 430 U.S. 188, 193 (1977)) (opinion by Judge Wilkinson).

⁵⁴ See *Mitchell*, 530 U.S. at 840-44; *Columbia Union College*, 254 F.3d at 504.

⁵⁵ See *supra* text accompanying notes 7-17.

⁵⁶ See, e.g., *Zelman v. Simmons-Harris*, 536 U.S. 639 (2002) (upholding a school voucher program enacted for a secular purpose that indirectly benefited the parents of parochial school students). The *Zelman* Court cited directly to *Mueller v. Allen*, 463 U.S. 388 (1983), for the proposition that a tax deduction for educational expenses, including the expense of tuition for parochial education, is constitutional “even though the great majority of the program’s beneficiaries (96%) were parents of children in religious schools.” at 649-50.

⁵⁷ *Mueller*, 463 U.S. at 390-91.

⁵⁸ *Zelman*, 536 U.S. at 653-54.

⁵⁹ *Mueller*, 463 U.S. at 396.; *Zelman*, 536 U.S. at 649-50; see also *supra* text accompanying notes 10, 16-17.

transactions that further those objectives. As noted above, the notion that the primary objective of Section 170 is to subsidize contributions to charitable organizations has considerable support. Whether the subsidy theory for Section 170, used in conjunction with a relatively restrictive jurisprudence on aid to religion, justifies the conclusion that expenses for parochial school tuition in particular ought to be deductible depends initially whether the payment of such expenses is in any way “charitable.” The latter inquiry is the topic of Part III.

III. LEGAL BACKGROUND: AMERICAN BAR, HERNANDEZ, AND SKLAR

As I mentioned in the introduction, the IRS permits deductions for charitable *quid pro quo* transactions with religious organizations and has done so for a long time, arguably starting in 1919.⁶⁰ Nearly sixty years later, in *United States v. American Bar Endowment*, the Supreme Court considered the deductibility of a truly bifurcated gift in which a majority of the “gift” was given in consideration for insurance services, a benefit not traditionally offered in exchange for or incidental to charitable donations.⁶¹ Given the nature of such a transaction, it would make little sense to permit a deduction for the entire “donation,” but “it would [also] not serve the purposes of [Section] 170 to deny a deduction altogether.”⁶² Thus, neither of the two easiest solutions (full

⁶⁰ See *supra* text accompanying note 21.

⁶¹ *United States v. Am. Bar Endowment*, 477 U.S. 105, 116-17 (1986). In truth, it is doubtful that the taxpayers in this case intended to make a gift. As such, using the language of gifts is perhaps misleading given that the very question before the Court was whether to *construe* the transaction as a gift. For the sake of brevity and simplicity, I am omitting a discussion of the facts of this case. The facts as presented are sufficient for full analysis given the purposes of this Article.

⁶² *Id.* at 117.

deduction or zero deduction) was appropriate. In light of this problem, the Court adopted a two-step test for calculating the deductible amount of such a gift. “First, the payment is deductible only if and to the extent it exceeds the market value of the benefit received. Second, the excess payment must be made with the intention of making a gift.”⁶³ If the first step of the analysis is satisfied, the second step is rather easy to satisfy, provided that the taxpayer knew he was paying too much and decided to do so anyway.⁶⁴

Where there is a functioning market for the goods or services in question, such that a going rate can readily be established, applying the first step in the *American Bar* analysis is rather easy. It becomes quite difficult, however, when the value of the benefit received is not easily measurable due to the absence of a functioning comparable market.⁶⁵ Justice O’Connor, writing three years later in her dissent in *Hernandez v. Commissioner*, argued that this very question, ignored by the Court’s majority, was at issue in *Hernandez*.⁶⁶

Taxpayers in *Hernandez*, members of the Church of Scientology, deducted payments for “auditing”⁶⁷ and “training”⁶⁸ (which are two

⁶³ *Id.* (internal citation and quotation marks omitted); *see id.* at 118, officially adopting this test.

⁶⁴ *See id.* at 118. For example, if an asset has a fair value of \$50 and the donor, aware of and not doubting the stated fair value, chose to pay \$75 for that asset, there is good reason to assume (as the Regulations do) that the \$25 difference was intended as a gift. Indeed, the \$25 is a bona fide charitable donation. Treas. Reg. § 1.170A-1(h)(5), ex. 2 (as amended in 2008).

⁶⁵ Kahn & Kahn, *supra* note 14, at 503.

⁶⁶ *Hernandez*, 490 U.S. at 705-06. (O’Connor, J., dissenting).

⁶⁷ “Auditing involves a one-to-one encounter between a participant (known as a ‘preclear’) and a Church official (known as an ‘auditor’). An electronic device, the E-meter, helps the auditor identify the preclear’s areas of spiritual difficulty by measuring skin responses during a question and answer session.” *Id.* at 684-85.

⁶⁸ This is a doctrinal course through which members of the Church study Scientology with a goal of obtaining the qualifications necessary to become an auditor.

religious services offered through Scientology). The Church charges a “fixed donation” for each service. These charges are set forth at length in various schedules, depending on the time required and relative sophistication of the desired religious service. In 1972, rates for auditing ranged from \$625 to \$4250.⁶⁹ Advance payment for these courses resulted in a 5% discount, and refunds were available for unused portions of the sessions.⁷⁰ Justice Marshall, writing for the Court in a 5-2 decision, concluded that it is “readily apparent” that these payments are not deductible gifts.⁷¹ He wrote:

[T]hese payments were part of a quintessential *quid pro quo* exchange: in return for their money, petitioners received an identifiable benefit, namely, auditing and training sessions. The Church established fixed price schedules for auditing and training sessions in each branch church; it calibrated particular prices to auditing or training sessions of particular lengths and levels of sophistication; it returned a refund if auditing and training services were unperformed; it distributed ‘account cards’ on which persons who had paid money to the Church could monitor what prepaid services they had not yet claimed; and it categorically barred provision of auditing or training sessions for free.⁷²

“Scientologists are taught that spiritual gains result from participation in such courses.” *Id.* at 685.

⁶⁹ *Id.*

⁷⁰ *Id.* at 686.

⁷¹ *Id.* at 694 n.10. The Court did not consider whether the transactions could have been viewed as “dual payments” under *American Bar* because the taxpayer did not argue as such. Nevertheless, given the analysis offered by Justice Marshall, we can assume that the payments would have failed step one of the *American Bar* two-step analysis because the Court would likely have found the amount paid equal to the value of services received.

⁷² *Id.* at 691-92.

It is difficult to understand what Justice Marshall intended with these words. Payments to religious organizations in exchange for benefits—even tangible benefits—are and have long been deductible. Indeed, a brief filed by Scientology in a subsequent case illustrates convincingly that the IRS permits charitable deductions for many similar religiously mandated *quid pro quo* transactions.⁷³ Justice Marshall claimed to have addressed this problem, referring to it as an “administrative consistency argument” and dismissing it for not being properly developed in the trial court.⁷⁴ In so doing, he glossed over important constitutional questions and “ignore[d] both long-standing, clearly articulated IRS practice, and the failure of the [Commissioner of Internal Revenue] to offer any cogent, neutral explanation for the IRS’ refusal to apply this practice to the Church of Scientology.”⁷⁵ Similarly, the *Hernandez* plaintiffs argued that Congress had acquiesced to permitting deductions for *quid pro quo* transactions with religious organizations by not overruling Revenue Rulings and the actions of the IRS despite modifying Section 170 several times in the intervening years. Again, Justice Marshall cited an incomplete record and dodged the question, despite citing to Revenue Ruling 70-47 in the same paragraph, which

⁷³ The brief cites donations required for attendance at Jewish high holy day services; to the Mormon Temple for religiously mandated tithes (10% of income must be paid to the Mormon Church); for Mass stipends to the Catholic Church paid in advance of and arguably in consideration for the celebration of a Mass; to a Hindu priest for performance of a puja (worship ceremony); for participation in a Zen Buddhist sesshins (meditation session with a Zen master for three to ten days) or a kesseis (meditation sessions typically of longer duration), both believed to be important for progress in the religion; and tithes of 10% of income to the Worldwide Church, a conservative Protestant denomination, which are required for membership to the Church. Petitioner’s Brief on the Merits in *Garrison, Garrison v. Comm’r*, 93 TNT 44-28 (1993).

⁷⁴ *Hernandez*, 490 U.S. at 701-03.

⁷⁵ *Id.* at 713 (O’Connor, J., dissenting).

provides that “[p]ew rents, building fund assessments, and periodic dues”⁷⁶ are all deductible under Section 170. That the payment of a pew rent is a *quid pro quo* transaction is definitional and, contrary to Justice Marshall’s suggestions, its application to the facts in *Hernandez* required no factual record or development. The words in the revenue ruling unequivocally established that the IRS permitted deductions under Section 170 for certain *quid pro quo* transactions. Justice Marshall’s punt on these important questions is perplexing and raises questions regarding the relevance of the *Hernandez* decision outside its specific facts.

Presumably, Justice Marshall found Scientology distinguishable from pew rents, not because the transactions were *quid pro quo* (even though that issue figured prominently in his decision), but because of the tremendously complex fee structure and exchange rules that made the Scientology transactions appear more like corporate transactions than religious donations.⁷⁷ It seems that *Hernandez* should be understood to require the non-deductibility of donations for payments in *quid pro quo* transactions where the transaction is governed by complex rules and schedules that make the transaction *feel* more like a standard commercial transaction. It remains unclear why the distinction between simple pay schedules and more complex pay schedules ought to be dispositive.

Alternatively, it is possible that Justice Marshall adjudicated the case assuming that Scientology is not a *bona fide* religion. Under this theory, he did not feel restrained by long-standing precedent to permit the deduction for the benefit of Scientology because that long-standing

⁷⁶ *Id.* at 701.

⁷⁷ *See supra* text accompanying note 72.

precedent relates only to *bona fide* religious organizations. If this theory is correct, *Hernandez* was a gross error; the Court failed to treat seriously the Commissioner's explicit stipulation that Scientology and related organizations would be considered as religious organizations for tax purposes.⁷⁸ Fearing such an error, Justice O'Connor chastised the majority and suggested that the repeated references to the commercial nature of the Scientology transactions represent a deliberate "attempt to negate the effect of the stipulations."⁷⁹ Justice Marshall made no response.

Taken on its face, *Hernandez* was not about the legitimacy of the Church of Scientology, the nature of its transactions with congregants, or its status as a religious organization. Rather, it was about the charitable nature of the specific transactions in question. However interpreted, the decision should have resulted in much litigation as transactions with only slightly different factual scenarios arose. Justice Marshall's failure to reconcile *Hernandez* with pew rents and other similar deductible transactions for intangible religious benefits begged Scientology to gather evidence regarding administrative consistency and the IRS's policy regarding the deductibility of expenses for such transactions. Also, public interest organizations that—incorrectly⁸⁰—view the Constitution as requiring religion to receive no assistance or support from the government under any circumstance would be expected to jump at the opportunity to challenge the deductibility of payments for pew rents. But this deluge of litigation never came, at

⁷⁸ *Hernandez*, 490 U.S. at 686 (majority opinion).

⁷⁹ *Id.* at 705 (O'Connor, J., dissenting).

⁸⁰ See generally *Bradfield v. Roberts*, 175 U.S. 291 (1899); *Bd. of Educ. of Cent. Sch. Dist. No. 1 v. Allen*, 392 U.S. 236 (1968); *Walz v. Tax Comm'n*, 397 U.S. 664 (1970); *Mueller*, 463 U.S. at 388; *Mitchell v. Helms*, 530 U.S. 793 (2000) (per both the plurality and Justice O'Connor's concurrence); *Zelman*, 536 U.S. at 639 (2002).

least not to the Supreme Court.

Following *Hernandez*, Scientology and related organizations filed “thousands of lawsuits . . . against the IRS in courts around the country” and fed “negative stories about the [IRS] to news organizations and support[ed] IRS whistle-blowers.”⁸¹ In 1993, the IRS appeared to fold under Scientology’s pressure, permitting members of the Church to deduct some measure of their payments for auditing and training. Some have speculated that the IRS willingly walked away from its victory in *Hernandez* because it knew that it could not defend the ramifications of the Court’s decisions.⁸² Perhaps hyper-separationist special interest litigation firms also declined to bring litigation in response to *Hernandez* knowing that the Court would be unwilling to extend its holding in *Hernandez*. According to the resulting closing agreement⁸³ (settling the lengthy and costly dispute between Scientology and the IRS), which remains confidential but was apparently leaked,⁸⁴ the IRS ceased ongoing audits of Scientology organizations, granted those organizations tax-exempt status, permitted donors to deduct 80% of their donations, and agreed to pay Scientology \$12.5 million.⁸⁵ *Hernandez* technically remains good law, but the parameters of its application are uncertain given that its holding is necessarily narrow (given its lack of theoretical justification,

⁸¹ Elizabeth MacDonald, *Scientologists and IRS Settled for \$12.5 Million—Accord in 1993 Also Called for Church to Set Up Tax-Compliance Panel*, WALL ST. J., Dec. 30, 1997, at A12.

⁸² See Samansky, *supra* note 23, at 100.

⁸³ See 26 U.S.C. § 7121 (authorizing the IRS to execute “closing agreements” with a taxpayer that conclusively resolves any disputes between the IRS and such taxpayer).

⁸⁴ Closing Agreement Between IRS and Church of Scientology, 97 TNT 251-24 (1997). The IRS claims the confidentiality of the agreement; it is unknown whether this version of the agreement is accurate or complete.

⁸⁵ MacDonald, *supra* note 81; *infra* note 99 (relating to the 80% figure).

inconsistence with prior precedent, and failure to resolve fundamental factual questions) and that, according to the closing agreement, *Hernandez* no longer applies to the Church of Scientology.⁸⁶

In the following tax year, 1994, and again in 1995, Michael and Marla Sklar deducted from their personal income tax returns 55% of their parochial school tuition expenses, the amount allocable to their children's religious education.⁸⁷ In 2000, the Tax Court found for the Commissioner of Internal Revenue, denying the 1994 deduction.⁸⁸ The Ninth Circuit, in an opinion by Judge Reinhardt, predictably affirmed the Tax Court in 2002.⁸⁹ *Sklar I* held that the taxpayers failed to meet the requirements of the *American Bar* test in part because they could not demonstrate that their tuition payments exceeded the market rate for their children's secular education (part one of the *American Bar* test).⁹⁰ The Sklars argued that the market value of the secular portion of their children's education was zero, the cost of public education. The court's response: "The Sklars are in error. The market value is the cost of a *comparable* secular education offered by the private schools."⁹¹ Obviously, the court was correct on this point.⁹² Public education is valuable education; it is free only to the end user but is a great expense to taxpayers⁹³ and a commodity to those who receive it.⁹⁴

⁸⁶ See John R. Valentine, *Religious Organizations, Quid Pro Quo Contributions, and Intangible Religious Benefits*, 16 TAX'N OF EXEMPTS 275, 285 (2005).

⁸⁷ *Sklar v. Comm'r*, 79 T.C.M. (CCH) 1815 (2000).

⁸⁸ *Id.*

⁸⁹ *Sklar I*, 282 F.3d at 610, 613-14 & n.3, 621-22.

⁹⁰ *Id.* at 621-22.

⁹¹ *Id.* at 621 (emphasis added).

⁹² *But see* notes 172-67.

⁹³ For the 1995-96 school year, public education cost government an average of approximately \$5500 per student. In California, where the Sklars reside, the costs were \$4878 per student. In New Jersey, public education costs were highest, at \$9318 per student. FINANCING, *infra* note 115, at 10 tbl.2.

The Ninth Circuit then attempted to adjudicate the case and in so doing failed to apply its own standard. The court declared: “The Sklars do not present any evidence even suggesting that their total payments exceeded *that cost*.”⁹⁵ Which cost? The court does not say. Apparently, the Ninth Circuit looked to the local market for private education to determine the market rate of the Sklar children’s secular education in their parochial schools, without making any attempt to show that the local market for private education is remotely comparable to the Sklar children’s education. If it can be shown, as I will attempt to do below, that the market for local private education is a markedly different market from the one in which the Sklars were operating, the Ninth Circuit’s decision appears to be conclusory. It remains, at best, an open question whether the facts of *Sklar* are at all related to the conclusion of the Ninth Circuit: “[U]nder the clear holding of *American Bar Endowment*, the Sklars cannot prevail on this appeal.”⁹⁶

In 2005, the Sklars returned to the Tax Court regarding the IRS’s the denial of the Sklars’ 1995 deduction.⁹⁷ The facts are materially the same, but the Sklars provided a more substantial factual record, expert testimony, and slightly revised arguments. Additionally, the IRS finally (after some prodding by the Ninth Circuit⁹⁸) stipulated, together with

⁹⁴ Report of Lewis C. Solomon, Ph.D. at 8-10, *Sklar v. Comm’r*, 125 T.C. 281 (2005) (No. 395-01). Reasonably comparable private education, however, should fairly accurately articulate the value of private education, assuming that the market for such education is competitive. *Id.*

⁹⁵ *Sklar I*, 282 F.3d at 621 (emphasis added).

⁹⁶ *Id.* The application of *American Bar* appears perfunctory absent some showing that *American Bar* ought to be relevant to *Sklar*.

⁹⁷ *Sklar II*, 549 F.3d at 1252.

⁹⁸ During the litigation of *Sklar I*, the IRS refused “to reveal to the Sklars, to [the Ninth Circuit], or even to the Department of Justice, the contents of its closing agreement.” *Sklar I*, 282 F.3d at 614-15. *Sklar I* held that such closing agreements are subject to public disclosure. *Id.* at 618. Over Sklar’s objections, the IRS declined

the Sklars, to the existence of a confidential closing agreement and that under the terms of that agreement, members of the Church of Scientology are permitted to deduct, under Section 170, 80% of their expenses associated with religious services provided by their church (presumably including the costs of auditing and training).⁹⁹ The Tax Court again affirmed the non-deductibility of parochial school tuition.¹⁰⁰

The Ninth Circuit, affirming the Tax Court and *Sklar I*, (1) cited *Hernandez* for the proposition that that “‘quid pro quo’ payments, where the taxpayer receives a benefit in exchange for the payment, are generally not deductible as charitable contributions.”¹⁰¹ In addition, *Sklar II* expressly rejected an argument that (2) amendments to the tax code enacted subsequent to *Hernandez* effectively overruled *Hernandez*,¹⁰² (3) held that the Sklars did not satisfy either step of the *American Bar* test,¹⁰³ and (4) rejected the Sklars’ arguments that the application of the closing agreement to Scientology and not to the benefit of any other religious denomination amounts to administrative inconsistency.¹⁰⁴

Sklar II’s articulation of the *Hernandez* test raises more questions than it answers. To reiterate, the Ninth Circuit implied that *Hernandez* held nondeductible all *quid pro quo* donations. On the face of that

to disclose the document in *Sklar II* and instead entered the above stipulation with the plaintiffs. *Sklar II*, 549 F.3d at 1264 & n.13.

⁹⁹ *Sklar II*, 549 F.3d at 1258.

¹⁰⁰ *Sklar*, 125 T.C. at 300.

¹⁰¹ *Sklar II*, 549 F.3d, at 1259.

¹⁰² *Id.* at 1262. Their statutory argument and the court’s response is beyond the scope of this Article. See Reply Brief for Appellants at 8-13, *Sklar v. Comm’r*, No. 06-72961 (9th Cir. Dec. 26, 2006); *infra* note 177 (pertaining to “intangible religious benefits”). The relevant section is I.R.C. § 170(f)(8)(B)(iii) (2000).

¹⁰³ *Sklar II*, 549 F.3d at 1263-64.

¹⁰⁴ *Id.* at 1266-67.

decision, payments for pew rents, synagogue dues, the use of Native American sweat lodges, and many other payments for intangible religious benefits undoubtedly claimed annually by tens of thousands of taxpayers in the Ninth Circuit are nondeductible. Presumably that is not what the court meant, but the court's failure to articulate a cogent rule that expressly excludes such transactions is conspicuous.

Similarly, *Sklar II* spoke in greater detail regarding step two of the *American Bar* test (imposing a requirement of charitable intent). (I commented above regarding *Sklar I*'s holding as it relates to step one of the *American Bar* test.¹⁰⁵) The Ninth Circuit, holding that the Sklars could not satisfy step two, came to the following astounding conclusion: "Because [the Sklars] paid for religious education out of their own deeply held religious views, and because the record demonstrates that throughout the school day . . . the schools inculcate their children with their religion's lifestyle, heritage, and values, the Sklars have actually demonstrated the absence of the requisite charitable intent."¹⁰⁶ Given the court's reasoning, *any* donation made in response to a conscientious compulsion is not "charitable." If I give money to my synagogue in satisfaction of a religious obligation, the Ninth Circuit's rule suggests that, as a matter of law, I too lack charitable intent. My intent is religious and my actions, as I define them, are obligatory. And yet it is completely beyond question—as a matter of statutory interpretation,¹⁰⁷ IRS rulings and practice,¹⁰⁸ the

¹⁰⁵ See *supra* text accompanying notes 90-96.

¹⁰⁶ *Sklar II*, 549 F.3d at 1263.

¹⁰⁷ The relevant portion of Section 170(c) reads "[T]he term 'charitable contribution' means a contribution or gift to or for the use of . . . (2) A corporation, trust, or community chest, fund, or foundation . . . (B) organized and operated exclusively for religious . . . purposes." 26 U.S.C. § 170(c)(2)(B).

¹⁰⁸ Rev. Rul. 70-47, 1970-1 C.B. 49.

history regarding the law of charities that led to the modern Section 170,¹⁰⁹ and the likely policy justifications for Section 170¹¹⁰—that my donation qualifies for a charitable deduction. Contrary to the Ninth Circuit’s suggestions, the charitable intent required by *American Bar* refers merely to the charitable objectives outlined in Section 170, as understood in the context of its history and defined by subsequent interpretation. Among those charitable objectives is the “advancement of religion.”¹¹¹ Accordingly, contributions given out of religious obligation may, nevertheless, be deductible provided that they are given with intent to advance religion or another charitable objective.

Finally, *Sklar II* rejected the Sklars’ administrative inconsistency argument by arguing that the Sklars were not similarly situated with the Scientology taxpayers who are subject to the closing agreement. Since no one (including the court) other than the members of the Church of Scientology and the IRS has ever seen the closing agreement, it seems rather odd to conclude that the Sklars were not similarly situated with Scientology. We would need to know the scope of the closing agreement and all relevant facts before jumping to that conclusion. But even assuming, as the Ninth Circuit apparently did, that the closing agreement pertains only to auditing and training services and stipulates that those services are *bona fide* religious services, it remains unclear why payments for religious education are not sufficiently similar to sustain an administrative consistency argument. *Sklar I* declared in dicta that “[r]eligious education for elementary or secondary school children does not appear to be similar to the ‘auditing’ and ‘training’

¹⁰⁹ See *supra* Introduction.

¹¹⁰ See *supra* Part I.

¹¹¹ See *supra* text accompanying notes 10, 16-17.

conducted by the Church of Scientology” but offered no explanation.¹¹² Perhaps the answer can be found in *Sklar II*'s discussion where the court, affirming the corresponding holding of the Tax Court, said: “We also conclude that tuition and fee payments to schools that provide secular and religious education *as part of one curriculum* are quite different from payments to organizations that provide *exclusively* religious services.”¹¹³ The implication of this statement is that if the Sklars’ tuition assessment was actually bifurcated into two payments—one to cover religious studies and the other for secular—the Sklars could have sustained an administrative consistency argument as it relates to the assessment for religious education. Alternatively, if the Sklars could have demonstrated, as I will argue shortly, that even the nominally secular education was religious in nature and a *bona fide* component of the Sklars’ religious education, the Sklars were similarly situated with Scientology and did set forth a potentially viable administrative consistency argument.

Recall that the Ninth Circuit, when questioning the Sklars’ charitable intent, affirmatively declared that the Sklars’ education is designed to “inculcate their children with their religion’s lifestyle, heritage, and values,”¹¹⁴ effectively suggesting that their secular education was, in a sense, religious. Here, the Ninth Circuit seems to be arguing that the Sklars’ secular education was not religious for the purpose of holding the Sklars in a materially different position than the taxpayers subject to the Scientology closing agreement. How can it be that the Sklars’ secular education is strictly secular for the purpose of

¹¹² *Sklar I*, 282 F.3d at 618 n.13.

¹¹³ *Sklar II*, 549 F.3d at 1264-65 (emphasis added).

¹¹⁴ *Id.* at 1263.

one jurisprudential analysis and entirely religious for the purpose of another?

IV. DEFINING THE MARKET: THE COSTS AND BENEFITS OF RELIGIOUS JEWISH EDUCATION

The purpose of this Part is to explore the economic transaction that parents such as the Sklars enter when they purchase parochial education. I have chosen to articulate my argument using the specific example of religious Jewish education and save further elaboration and delineation of the underlying theoretical argument about the valuation of goods in religious markets for a future date.

It is well known that the costs of private education are very high—prohibitively high for many parents—and yet an overwhelmingly large percentage of the religious Jewish community sends its children to parochial school. We must conclude either that parents in the religious Jewish community are disproportionately and universally wealthy, that their schools are rather inexpensive, or that parents in this community have decided in large numbers to make tuition payments they cannot reasonably afford. Of those three possibilities, only the last seems plausible. The first possible conclusion, relating to Jewish affluence, would be based on little more than conjecture or invidious stereotype absent considerable evidence to the contrary. The second possible conclusion is factually false as religious Jewish school tuition in 2001 ranged from \$5000 to nearly \$18,000 per student per year, with the median at approximately \$10,000.¹¹⁵

¹¹⁵ JACK WERTHEIMER, TALKING DOLLARS AND SENSE ABOUT JEWISH EDUCATION 7, 9 (2001) [hereinafter DOLLARS AND SENSE], *available at* <http://www.avi-chai.org>

The prohibitive costs of tuition are best illustrated by appeal to a concrete example. The Jewish Community Foundation of MetroWest recently performed a budget analysis to calculate the expendable income of a family with a single-wage earner, an annual income of \$150,000, and no private school tuition expenses living in Morris County, New Jersey (an area with a sizable religious Jewish population).¹¹⁶ The analysis assumed a house costing \$500,000¹¹⁷ or, alternatively, \$600,000, with an 80% fixed 30-year mortgage at 6% interest. The Foundation calculated federal taxes, local taxes, and mortgage payments at approximately \$79,000 (or \$84,000 assuming a \$600,000 house). They then calculate other high priority discretionary expenses (such as food and clothing) at approximately \$65,000. The largest expenses are \$10,000 for auto payments¹¹⁸ and \$9000¹¹⁹ for

(navigate to the Home Page and then to the Knowledge Base page and scroll to “Research Reports - North America”). For the 1995-96 school year, public education cost government approximately \$5500 per student on average. MARVIN SCHICK & JEREMY DAUBER, *THE FINANCING OF JEWISH DAY SCHOOLS* 10 tbl.2 (1997) [hereinafter *FINANCING*], available at <http://www.avi-chai.org> (navigate to the Home Page and then to the Knowledge Base page and scroll to “Research Reports - North America”). Recent figures for public education are much higher. One commentator calculates that the District of Columbia public schools spent an astounding \$24,600 per pupil in the 2007-08 school year. Andrew J. Coulson, *The Real Cost of Public Schools*, Apr. 7, 2008, <http://www.cato-at-liberty.org.2008/04/07/the-real-cost-of-public-schools/>. The Department of Education sets the per pupil expenditures for the 2006-07 school year at \$11,257. NAT’L CTR. FOR EDUC. STAT. DIGEST OF EDUC. STAT.: 2009 tbl.182 (2009), available at http://nces.ed.gov/programs/digest/d09/tables/dt09_182.asp? (last visited July 13, 2010).

¹¹⁶ JEWISH COMMUNITY FOUNDATION OF METROWEST, HEBREW ACADEMY OF MORRIS COUNTY TUITION ASSISTANCE COMMITTEE REPORT: HYPOTHETICAL NEW FAMILIES (2008) [hereinafter *MORRIS*], available at <http://peje.wikispaces.com/file/view/hamc-hypotheticalnewfamilies-costofliving-2008.pdf>.

¹¹⁷ *Id.* Presumably, this figure is based on median prices for the region.

¹¹⁸ *Id.* It is unclear if the category “car” includes maintenance expenses.

¹¹⁹ *Id.* While I do not opine on the reasonableness of these estimates, I note anecdotally that many religious Jewish families are large. Families of six or more children are common in religious circles. *FINANCING*, *supra* note 115, at 15.

food.¹²⁰ This leaves an annual disposable income of just \$5576 per *family* (not per student), or just \$444 per family assuming a \$600,000 house.¹²¹ Religious Jewish school tuition rarely costs less than—and is typically significantly more than¹²²—\$5000 per *student*.¹²³ It follows that religious Jewish school education is grossly unaffordable for families making \$150,000 in Morris County.

The record in the *Sklar* litigation¹²⁴ provides no indication of the Sklars' ability to pay tuition, other than representing that they were able to make their payments without financial assistance. But the fact they declined or did not qualify for tuition assistance does not indicate that the payments (\$27,283 in 1995)¹²⁵ were affordable or economically efficient. In the religious Jewish tradition, day schools are not a luxury; they are a necessity: "In the Jewish worldview, Jewish education is not a consumer good . . . but a communal [religious] obligation."¹²⁶ Indeed, Jewish law has mandated that Jewish

Additionally, certain kosher products are more expensive than their non-kosher counterparts. A \$9000 food allowance (amounting to approximately \$170 per week) may actually be too conservative.

¹²⁰ MORRIS, *supra* note 116. The entire list: "Car"; Car Insurance; Property Insurance; Life Insurance; Utilities; Food; Clothing; Medical; Gasoline; Synagogue (presumably referring to dues); Vacation Expenses; College Savings (just \$7500 per year for the whole family); Telephone, Cable, & Internet; and Home Maintenance. *Id.*

¹²¹ *Id.*

¹²² See *supra* text accompanying note 115.

¹²³ DOLLARS AND SENSE, *supra* note 115.

¹²⁴ See *supra* Part II.

¹²⁵ *Sklar*, 125 T.C. at 281, 287-88. The payments average to approximately \$5500 per child at two Los Angeles area schools. *Id.* at 283. Those numbers appear quite low, considering that the Sklars received no financial assistance in 1995, *id.* at 282, 287; and given that average annual Jewish religious school tuition in Los Angeles in 1998 cost \$7800 in elementary schools and \$10,700 in high schools. DOLLARS AND SENSE, *supra* note 115, at 7.

¹²⁶ Yossi Prager, *The Tuition Squeeze: Paying the Price of Jewish Education*, JEWISH ACTION, Fall 2005 13, 16; see also THIRD CENSUS, *infra* note 140, at 5 (describing parochial school education for Orthodox children as a "mandatory").

communities establish and maintain schools for every child for the past 2000 years.¹²⁷ Accordingly, many parents opt to pay full tuition out of a sense of religious obligation, even though doing so causes significant hardship.¹²⁸ More commonly, due to lack of capital, schools cannot provide parents with financial aid sufficient to cover demonstrated need. Rabbi Hershel Lutch, serving at the time of the interview as the executive director of a large Orthodox Jewish school in Greater Washington, D.C., told me that 98% of his school's client base cannot readily afford to pay tuition but only 60% of them are on tuition assistance. Of the parents on tuition assistance, approximately 70% do not receive the amount of aid they requested. Rabbi Lutch candidly indicated that very few of his school's aid applications raise suspicion of fraud, that most of the applicants were able to demonstrate legitimate need, and that scholarship denials create palpable burdens on the school's parents. He lamented: "We know that the Jewish parochial system—on a national level—is impoverishing people and we know that families are falling into debt."¹²⁹ Nevertheless, these parents continue to send their children to school and continue to make their payments.

The schools try to make their tuition as affordable as possible, also out of a sense of religious communal obligation. "In most Orthodox communities, tuition does not limit enrollment, but it does place a great strain on families" and schools.¹³⁰ To facilitate high enrollment, most religious schools do not collect revenues anywhere near their total

¹²⁷ Prager, *supra* note 126, at 13.

¹²⁸ Interview with Rabbi Hillel Tendler, President, Torah Institute of Baltimore, in Baltimore, Md. (Oct. 5, 2008).

¹²⁹ Telephone Interview with Rabbi Hershel Lutch, Executive Director, Torah School of Greater Washington (Oct. 12, 2008).

¹³⁰ See Prager, *supra* note 126, at 14.

operating budgets through tuition payments exclusively. For example, a study of Denver's religious Jewish day schools published in the year 2000 showed a significant gap between tuition collections and total revenue among Orthodox schools, ranging from 63% of revenue to just 32.4%.¹³¹ Apparently, several other schools around the country are also unable to raise even one-third of their revenues through tuition collections.¹³² This problem is in no way unique to Jewish schools. The Department of Education reports that tuition in inner-city Catholic schools covers only 58% of costs.¹³³ Instead, such schools must rely very heavily on private donation and, to the limited extent it is available, government assistance.¹³⁴ Raising as much as two-thirds of an operating budget primarily through private donation can be difficult. Accordingly, many schools have chosen to detrimentally shrink their budgets to enable as many students as possible to attend. "Because of the high costs of meeting their budgets and construction costs, day schools often give short shrift to several other needs. These include:

¹³¹ DOLLARS AND SENSE, *supra* note 115, at 8 tbl.1.

¹³² *Id.* at 7.

¹³³ U.S. DEP'T OF EDUC., PRESERVING A CRITICAL NAT'L ASSET: AMERICA'S DISADVANTAGED STUDENTS AND THE CRISIS IN FAITH-BASED URBAN SCHOOLS 19 (2008) (citation omitted).

¹³⁴ See *supra* text accompanying notes 52-54. It is worth noting here that federal law is not the only bar to government funding for parochial schools. Approximately forty states have provisions in their constitutions known as Blaine Amendments. The Blaine Amendments were largely adopted between 1849 and 1910, a period marred by severe anti-Catholic bigotry. They were part of an effort by the Know-Nothings (or the American Party), the American Protective Association, and the KKK (each in their time) to stifle the growing Catholic community in the United States. They did so by explicitly or effectively making it impossible for Catholic schools to receive state funds. See generally, e.g., RAY ALLEN BILLINGTON, THE PROTESTANT CRUSADE, 1800-1860: A STUDY OF THE ORIGINS OF AMERICAN NATIVISM (Quadrangle Books 1964) (1938); JOHN HIGHAM, STRANGERS IN THE LAND: PATTERNS OF AMERICAN NATIVISM, 1860-1925 (Rutgers Univ. Press 2002) (1955); see also Mitchell v. Helms, 530 U.S. 793, 828-29 (2000) (discussing the attempt to enact a Blaine Amendment in the Federal Constitution). For more on the Blaine Amendments, see <http://www.blaineamendments.org>.

adequate salary and benefit packages for their faculty and staff, purchasing and maintaining computer equipment, . . . developing proper curricula and providing enrichment for faculty.”¹³⁵ Not surprisingly, one study on school funding for the 1995-96 school year found that “[t]he average per capita expenditures in Jewish day schools, which encompass a dual track education program comprised of separate Judaic and secular components and faculty, are well below comparable expenditures at private schools and about the same as they are in public schools which offer only a secular program.”¹³⁶ This “extensive underfunding” results in harmful reductions to “salaries paid to faculty, extracurricular activities and the availability of electives and auxiliary course offerings for gifted and special students.”¹³⁷ Underfunding complicates recruitment and retention of qualified teachers and, at times, results in a faculty that is less well qualified on balance¹³⁸ and possibly even less competent.¹³⁹

In short, parents are making payments they cannot reasonably afford and schools are operating despite suffering severe budgetary constraints that are not in the interests of the school or its students. If so, we can assume that the schools are very sensitive to changes in cash flow and should expect periods of economic instability to be particularly harmful to these religious schools. That is, in fact, what we observed following the economic downturn in 2001.¹⁴⁰ Of sixty

¹³⁵ DOLLARS AND SENSE, *supra* note 115, at 9.

¹³⁶ FINANCING, *supra* note 115, at iii.

¹³⁷ *See id.*

¹³⁸ Telephone Interview with Rabbi Hershel Lutch, Executive Director, Torah School of Greater Washington (Oct. 12, 2008).

¹³⁹ *See* FINANCING, *supra* note 115, at 12.

¹⁴⁰ MARVIN SCHICK, THE IMPACT OF THE ECONOMIC DOWNTURN OF JEWISH DAY SCHOOLS (2003) [hereinafter DOWNTURN], *available at* <http://www.avi-chai.org> (navigate to the Home Page and then to the Knowledge Base page and scroll to

Orthodox schools responding to a survey in 2003, fifty-two said they had an increase in scholarship requests during the economic downturn and forty-six of them defined the increase as “significant.”¹⁴¹ The number of arrears in tuition obligations increased dramatically. Forty-three of fifty-nine (73%) reporting Orthodox schools cited an increase in “arrears.”¹⁴² Thirty-five (59%) schools labeled the increase “serious.” One school expressly commented that a “significant number of parents have put mid-year payments on hold.”¹⁴³ Further, of sixty responding Orthodox schools, forty-one (68%) reported that they were “experiencing greater difficulty this year meeting [their] budget[s].”¹⁴⁴ Thirteen of them reported being late on payroll and ten of them had to reduce staffing.¹⁴⁵ Additionally, some schools reported that they would not be increasing salaries for 2003 or 2004 and two schools incurred debt to meet their payrolls.¹⁴⁶ Nevertheless, only eight of sixty (13%) Orthodox schools responding to the survey said that the downturn caused a decline in enrollment. Compare that figure with enrollment deficits in fourteen of twenty-seven respondents (52%) among non-Orthodox Jewish schools.¹⁴⁷ The severe global recession starting in

“Research Reports - North America”). The impact that the severe global recession starting in 2008 has taken on enrollment at Orthodox schools is not yet known. We do know that the schools are reporting greater difficulty collecting tuition and in raising funds through donations. Many schools have been forced to downsize and further staff reductions are likely. MARVIN SCHICK, *A CENSUS OF JEWISH DAY SCHOOLS IN THE UNITED STATES, 2008-2009* (2009) [hereinafter *THIRD CENSUS*], available at <http://www.avi-chai.org> (navigate to the Home Page and then to the Knowledge Base page and scroll to “Research Reports - North America”); see also notes 148-149.

¹⁴¹ DOWNTURN, *supra* note 140, at 7 tbl.4.

¹⁴² *Id.* at 8 tbl.5.

¹⁴³ *Id.* at 8.

¹⁴⁴ *Id.* at 9 tbl.6.

¹⁴⁵ *Id.* at 10 tbl.7.

¹⁴⁶ *Id.* at 9, 10.

¹⁴⁷ *Id.* at 4 tbl.2.

2008 is undoubtedly further exacerbating the problems for all private schools. A survey of the Jewish day schools in the United States indicated that *all* of them report that recession has adversely affected their finances to some extent.¹⁴⁸ Nevertheless, during the period from 1998-2009, Jewish day school enrollment managed to increase by “nearly” 25%.¹⁴⁹ These figures indicate an extremely inelastic market despite very high sensitivities to capital availability both on the supply side and on the demand side. This is an unusual scenario that cannot easily be explained by appeal to economic theory.

Surely, religious traditionalists are not the only people who pay for private education beyond their means. Many people might opt to do the same for social reasons, to provide a better education than is available in local public schools, or for any number of other reasons. What makes these observations interesting as they relate to the Orthodox Jewish population is the fact that they describe a whole class of people, rather than a collection of individuals. When one person makes an isolated decision to send her children to private school, that singular decision might be explainable by appeal to rational economic theory (even if it is the product of flawed reasoning). But when a whole class of people sends its children to private school, despite not being able to afford it, economic explanations are less compelling.

The only conclusion that I can draw from these data is that the market for religious Jewish education is not governed by “rational”¹⁵⁰ decision-making. Parents pay more than they can afford and schools

¹⁴⁸ THIRD CENSUS, *supra* note 140, at 5 n.5.

¹⁴⁹ *Id.* at 5. Total enrollment in 1998 was 184,333. Total enrollment in 2008 was 228,174, an increase of 23.78%. *See id.* at 6 tbl.2.

¹⁵⁰ “Rational” is used here as a term of art under economic theory and does not indicate a normative judgment. It also does not indicate that failure to adhere to rational economic theory is inherently “irrational,” as that word is commonly used.

accept less than they can afford in order to achieve a transaction that is economically inefficient and arguably should not be taking place. The net result is a school that is underfunded, that cannot sufficiently pay its teachers under normal circumstances and may not be able to pay its teachers at all when cash flows cycle down, and cannot properly compete with many public schools or well-funded private schools.¹⁵¹

Why do religious schools that engage in inefficient transactions that cause their own economic hardship continue to provide secular education when they could easily ask their students to attend public school in the morning and early afternoon and come to the religious school in the late afternoon? From an economic perspective, this approach would make a lot of sense. Apparently, the schools believe that there are important *religious* ends served by providing secular education in a religious environment. Said differently, these schools engage in religious “instruction” all day, irrespective of whether their students are learning theology or calculus. In the words of one commentator: “Jewish schools are more necessary than ever to shape young Jews sufficiently dedicated to Torah to withstand the centrifugal pull of an assimilationist American culture.”¹⁵²

Indeed, this is probably what the Ninth Circuit meant when it wrote in *Sklar II* that “the schools inculcate . . . children with their religion’s lifestyle, heritage, and values.”¹⁵³ Moreover, it is almost certainly what the *Sklar* taxpayers meant when they said that they sent their children to religious school “because of their sincerely and deeply held religious belief that as Jews they have a religious obligation to

¹⁵¹ See FINANCING, *supra* note 115, at 12-13.

¹⁵² Prager, *supra* note 126, at 13.

¹⁵³ *Sklar II*, 549 F.3d at 1263.

provide their children with an Orthodox Jewish education in an *Orthodox Jewish environment*.”¹⁵⁴ The motivation for these *quid pro quo* transactions is apparently religious in nature. Religious schools provide a lot more than an education in religious and secular subjects; they provide a religious socialization and worldview as well. Parents feel an obligation to send their children, and schools feel an obligation to accept any child who wants to come, and both sides seem prepared to suffer the economic consequences of those decisions.

To my knowledge, the only federal trial court to ever collect, consider, and weigh evidence regarding the fundamental function of Jewish religious day schools reached precisely the same conclusions. The district court in the Southern District of New York was forced to decide in *Westchester Day School* whether a Jewish school’s proposed construction project, which had the school adding many new classrooms to be used principally for secular instruction, should be deemed sufficiently necessary for the school’s religious exercise to award that project special protections under federal statute.¹⁵⁵ The court found that “virtually all of the general studies courses are permeated with religious aspects and the entire faculty (including general studies teachers) cooperate on various Judaic and Jewish themed activities”

¹⁵⁴ *Id.* (emphasis added).

¹⁵⁵ The Religious Land Use and Institutionalized Persons Act, 42 U.S.C. § 2000cc (2000) *et seq.* (RLUIPA), provides in pertinent part:

No government shall impose or implement a land use regulation in a manner that imposes a substantial burden on the religious exercise of a person, including a religious assembly or institution, unless the government demonstrates that imposition of the burden on that person, assembly, or institution-- (A) is in furtherance of a compelling governmental interest; and (B) is the least restrictive means of furthering that compelling governmental interest.

42 U.S.C. § 2000cc(a)(1).

and that the school's facilities are "in whole and in all of their constituent parts are used for religious education and practice—*i.e.*, devoted to religious purposes."¹⁵⁶ Additionally, the court quoted testimony stating that "[e]very part of [the students'] day is spent studying religion [When] studying social studies or science or math, there will be religious and Judaic concepts that come into play."¹⁵⁷ Further, "religion plays a part in [the school's] daily whole, and throughout the day [students] are involved in general things and holy things, and they go back and forth."¹⁵⁸ The court also quoted expert testimony from Dr. Marvin Schick, an author of several hundred articles on Jewish education,¹⁵⁹ as follows:

The Jewish day school obviously has these two purposes, the general educational purpose and the general socialization purpose. . . . [The] socialization function . . . is to teach children certain modes of behavior which fit into the Jewish faith and carry out various traditions, such as going to synagogue, praying; not merely praying in the sense of being able to read, but to understand and have feelings about their community and the commitments to their community.¹⁶⁰

He opined further that it is "virtually mandatory" for Orthodox Jewish parents to enroll their children in such schools.¹⁶¹ By extension, the socialization provided by these schools, one of the essential

¹⁵⁶ *Westchester Day Sch. v. Village of Mamaroneck*, 417 F. Supp. 2d 477, 496, 498 (S.D.N.Y. 2006).

¹⁵⁷ *Id.* at 495 (first alteration in original).

¹⁵⁸ *Id.* at 496.

¹⁵⁹ *See id.* at 494 n.13.

¹⁶⁰ *Id.* at 497.

¹⁶¹ *Id.*

components of the schools, is a vital part of the religious Jewish experience. As mentioned, that socialization occurs during secular studies as much as during religious studies. The Second Circuit affirmed the district court's holding that the building was to be used for religious exercise, even if secular subjects were taught within,¹⁶² noting that "[e]ven general studies classes are taught so that religious and Judaic concepts are reinforced."¹⁶³

With this in mind, it is now possible to understand why parents and schools are willing to enter these inefficient and superficially detrimental transactions.¹⁶⁴ Parochial education is viewed in their circles as imperative to the survival of religious tradition. If so, virtually any expense is justified if necessary to keep kids in the schools and the school doors open, even if quality of their education suffers. Indeed, one parent whose testimony was recorded by the district court in *Westchester Day School* said that she pays tuition (between \$11,000 and \$17,000 per student per year, depending on grade level) for *both* the Jewish education and the socialization that the school provides.¹⁶⁵ The court concluded that the school's "religious mission" was the "one reason" that drives parents to enroll their children at great expense, and that if the ability of the school to further its mission were compromised, the school would not be able to persist.¹⁶⁶

Upon reflection, the 2003 study that showed 13% of schools

¹⁶² *Id.* at 544-46 & n.76.

¹⁶³ *Westchester Day Sch. v. Village of Mamaroneck*, 504 F.3d 338, 344 (2d Cir. 2007).

¹⁶⁴ Identifying a mere "religious" motivation, as I did earlier, is insufficient because it is well-known that *all* charitable donations fluctuate in accord with available capital. *See supra* text accompanying notes 24-30.

¹⁶⁵ *Westchester Day School*, 417 F. Supp. 2d at 497.

¹⁶⁶ *Id.* at 498, 571.

reporting a declining enrollment during a period of economic hardship is strikingly high, given that Orthodox circles view religious day school attendance as a “religious obligation” and that this obligation is “reinforced by social pressure.”¹⁶⁷

The Ninth Circuit in both *Sklar I*¹⁶⁸ and in *Sklar II*¹⁶⁹ denied the Sklars a charitable deduction because their tuition payments were not in excess of the value of their secular education, as determined by appeal to “comparable” markets. The difficulty is that there are no comparable markets because the market for secular private education is a market for education, not a religious environment or for socialization.¹⁷⁰ The Sklars were not exclusively or primarily purchasing a secular education, rather, they were purchasing a religious environment in which to educate their children and to aid their socialization into Jewish life. Accordingly, 100% (not just 55%, as the Sklars claimed)¹⁷¹ of the costs of their tuition was allocable to the religious experience and training of their children, and therefore should

¹⁶⁷ DOWNTURN *supra*, note 140, at 5; *see supra* text accompanying note 147.

¹⁶⁸ *Sklar I*, 282 F.3d at 621.

¹⁶⁹ *Sklar II*, 549 F.3d at 1264.

¹⁷⁰ *See supra* text accompanying notes 91-96. It is noteworthy that the expert testimony provided by the Sklars argued that local Catholic schools provide a comparable market and found the Sklars eligible for a deduction of nearly \$5000 per student per year. Report of Lewis C. Solomon, *supra* note 94 at 17. He came to that conclusion by comparing a number of objective factors that affect the value of secular education. I believe that this is insufficient. To find the Catholic schools comparable, it is necessary to perform a sociological analysis to determine if Catholic schools provide the same type of religious benefits and environment that certain Orthodox schools provide to religious Jewish students even during the pursuit of secular studies. The expert testimony provides ample reason to conclude that Catholic schools are *not* comparable to the Sklar’s schools on sociological and religious grounds. For example, he finds the Sklars’ schools spend between 33% and 46% of their time on secular studies while the local Catholic school spent nearly 86% of its time on secular studies. *Id.* at 12 tbl.3. This discrepancy suggests that the atmosphere and emphasis of the two schools are significantly different and, accordingly, may not be comparable.

¹⁷¹ *See supra* text accompanying note 87.

be tax deductible under Section 170 as that statute is written and was intended.

Surely their secular education, which comes packaged with the religious environment and socialization that the Sklars purchased for their children, has value. Indeed, it has considerable value, as *Sklar I* correctly explained.¹⁷² But that fact has nothing to do with the Sklars' charitable intent. Their intent, rather, is ascertained not by looking at gross acquisition, but by marginal analysis. What do they stand to gain via this transaction and what do they stand to lose? They already have, by right, access to free public education. By separately purchasing parochial education, their marginal acquisition is a religious environment for their children, socialization, and a religious education. Their marginal costs are the expense of tuition and the *quality of their children's secular education* (on the assumption that public schools, which spend far more money on secular education than do parochial Jewish day schools, see greater returns on their investment¹⁷³). This is so because public education is generally financed through mandatory property taxes that all homeowners are obligated to pay, regardless of whether they have children or send their children to private school. The *marginal* financial cost of sending a child to public school is indeed \$0. So while the Sklars' tuition payments technically go to finance the cost of the entire education of their children, including their secular education, the Sklars' marginal gains—and thus the intent motivating their transaction—are exclusively religious.¹⁷⁴

¹⁷² See *supra* text accompanying notes 91-94.

¹⁷³ See *supra* notes 115, 125, & 170.

¹⁷⁴ Upon reading an earlier version of this paper, someone asked me whether under "my theory" tuition payments to post-secondary religious schools would be deductible. Clearly, given the analysis in this paragraph, they would not be. The

Still, some might argue, that under the rule of *American Bar*,¹⁷⁵ the transaction must be bifurcated, and the value of the children's secular education must be subtracted from the cost of tuition before any deduction may be taken. *American Bar* involved taxpayers who claimed that they overpaid on their insurance policies (which are obviously secular and commercial objects of value that were purchased with intent) and wanted to deduct the overpayment from the federal taxes. Parents who send their children to parochial school do not intend to purchase any secular goods whatsoever. They have access to public school—a presumptively better purchase or economic investment—at no additional cost to them. If they intended to procure a secular education, sending their children to parochial school at great expense would be rather foolish. Because their exclusive intent in engaging in this transaction is religious and all of their marginal benefits from the transaction are religious in nature, *American Bar* has no application to the present question, except to the extent that *American Bar* helps define charitable donations generally.

marginal cost of religious primary and secondary education *vis-à-vis* secular alternatives is quite high because the price of nominally comparable secular alternatives is \$0. When the alternative is free, every dollar spent for education is a net marginal cost that is being paid for a strictly intangible religious benefit, and is thus deductible. The nominally comparable secular alternative to post-secondary religious education is an academically comparable college or university. Presumably, the price of attending the post-secondary religious school is not demonstratively more than the price of roughly comparable secular education. If it is, it is likely not significantly so, and given that the decision of where to go to college is often influenced by a multitude of factors, it is difficult to presume that the extra price is strictly a premium for the intangible religious benefit of attending the religious school. Even where the price of the religious college is significantly greater (such as if the student turned down a scholarship to a secular school), the burden of proving that the decision to pay more and attend the religious school was motivated primarily by the charitable interest of advancing religion will be difficult to meet. The very fact that the student bothered to apply to a secular school may suggest that the student's desire for a religious educational environment is not a primary interest.

¹⁷⁵ See *supra* text accompanying notes 60-63.

Assuming, *arguendo*, that the *American Bar* test is applicable to the present analysis, there is an initial question that must be answered before the *American Bar* test may be applied: What is the value of the secular education provided at parochial schools? Typically, to assign value to such a service, we would want to look to comparable healthy markets; but there are no comparable markets.¹⁷⁶ As Justice O'Connor observed dissenting in *Hernandez*, this problem is endemic to the world of *quid pro quo* donations given in exchange for intangible religious benefits:

It becomes impossible . . . to compute the “contribution” portion of a payment to a charity where what is received in return is . . . an intangible . . . that is not bought and sold except in donative contexts so that the only “market” price against which it can be evaluated is a market price that always includes donations [I]f one buys a \$100 seat at a prayer breakfast receiving as the *quid pro quo* food for both body and soul—it would make no sense to say that no charitable contribution whatever has occurred simply because the “going rate” for all prayer breakfasts . . . is \$100. The latter may well be true, but that “going rate” *includes* a contribution.¹⁷⁷

¹⁷⁶ See *supra* note 170.

¹⁷⁷ *Hernandez*, 490 U.S. at 706-07 (O'Connor, J., dissenting) (emphasis original). In truth, this example is outdated. Section 6115 of the Internal Revenue Code now provides that a recipient of any *quid pro quo* contribution in excess of \$75 must explain to the donor in writing that a charitable deduction will be permitted only to the extent that the contribution exceeds the estimated fair market value of the goods or services provided by the donee. I.R.C. § 6115 (2000). Justice O'Connor's analysis, nonetheless, remains relevant because it illustrates the challenge of valuing charitable *quid pro quo* donations to religious organizations. Current law is sensitive to this challenge. The Regulations provide that where the donee provides goods not available in commercial markets, the donee may perform valuation by reference to the fair market value of “similar or comparable goods” even if the similar or

The Sklars' tuition payments were the culmination of such a transaction. The Sklars were buying a religious environment for their children, which they apparently felt was imperative to the proper development of their children. By implication, they intended to support their children's school. A portion of the payment to the school went to subsidize the cost of their children's secular instruction. But how much? Even if we could reliably divide the day between secular time and religious time (as the Sklars attempted to do, arriving at the conclusion that 55% of their tuition is deductible¹⁷⁸), use of that division is a rather arbitrary means of discerning the *value* of the Sklar's secular education. Justice O'Connor continues:

Confronted with this difficulty, and with the constitutional necessity of not making irrational distinctions among taxpayers, and with the even higher standard of equality of treatment among religions that the First Amendment imposes, the Government has only two practicable options with regard to distinctively religious *quids pro quo*: to disregard them all [and allow a full deduction], or to tax them all. Over the years it has chosen the former course.¹⁷⁹

Of course, Justice O'Connor dissented in *Hernandez*. Her

comparable goods do not possess qualities unique to the goods provided. Treas. Reg. § 1.6115-1(a) (1996). Where there are no similar or comparable goods, as is sometimes the case in religious quid pro quo transactions, Section 170(f)(8)(B)(iii) appears to offer some guidance. It provides that although taxpayers claiming a charitable deduction for contributions over \$250 need to provide written substantiation describing and valuing any goods or services received, they need not provide the value of "intangible religious benefits" (suggesting that the monetary value of such benefits, if any, is legally negated). I.R.C. § 170(f)(8)(B)(iii) (2000).

¹⁷⁸ See Sklar v. Comm'r, *supra* note 87.

¹⁷⁹ *Hernandez*, 490 U.S. at 707 (O'Connor, J., dissenting); see my discussion and application to modern law, *supra* note 177.

arguments cannot be readily applied to new cases to the extent that the majority disagreed with those arguments, unless *Hernandez* has been overruled or is distinguishable. The Sklars argued that Congress has overruled *Hernandez*.¹⁸⁰ Above, I interpreted *Hernandez* and concluded that *Hernandez* should be read narrowly and, in any event, there are sufficient grounds to distinguish *Hernandez* from *Sklar*.¹⁸¹ Accordingly, there should be no impediment to concluding either (1) *American Bar* is just not applicable to parochial school tuition payments that provide no marginal secular benefit and are made for purely religious purposes or, (2) as Justice O'Connor suggested in *Hernandez*, valuation of the Sklars' secular education is technically infeasible and therefore, consistent with IRS practice, unnecessary.

V. SUBSIDY THEORY AND THE POLICY IMPLICATIONS OF PERMITTING TUITION DEDUCTIONS

Subsidy theory and its specific application in the context of donations to religious organizations was introduced in Part I.¹⁸² Subsidy theory is particularly useful as a policy justification for the charitable deduction for payments that would not be made but-for the charitable deduction. Payments for religious school tuition, some argue, do not fit that definition because they occur presently despite not being eligible for charitable deductions.

The foundation of subsidy theory, as demonstrated by the legislative history that supports it, is the recognition of the importance

¹⁸⁰ Reply Brief for Appellants at 8-13, *Sklar v. Comm'r*, No. 06-72961 (9th Cir. Dec. 26, 2006). See also *supra* note 177 (pertaining to "intangible religious benefits"); I.R.C. § 170(f)(8)(B)(iii) (2000).

¹⁸¹ See *supra* text accompanying notes 72-79.

¹⁸² See *supra* text accompanying notes 34-49.

of supporting public charities dedicated to improving social welfare that need the money to properly achieve their charitable objectives. One editorial included in the 1917 Congressional Record states that heavy taxation in the absence of a charitable deduction would “cut[] sharply into th[e] very source of supply on which so much of our welfare depends. In th[e] predicament [of heavy taxation during World War I] the very least which the United States Government can do is leave these sources of supply as wide open as still may be possible.”¹⁸³ That sentiment is fully applicable to a network of religious schools that is constantly at risk of economic hardship. Parents are only able to make their tuition payments because the prices set by the schools are far too low to cover their operating costs. Government subsidy is then unnecessary only if (1) rising costs do not outstrip inflation, (2) the existing ratio of parents to children does not decrease, and (3) we are willing to allow the schools to continue to remain perennially underfunded. But the first two are unlikely. And the third is contrary to public policy, assuming that the goal of the charitable donation for religious organizations is to provide a subsidy so that those institutions may improve the public welfare. Given that assumption, it is necessary to enable the schools to efficiently provide the services to the public that they desire to provide. Because current funding levels reduce the quality of education that these schools are able to provide, additional subsidization would improve the social function of these public charities. If we are concerned that school enrollment will continue to grow at a faster rate than the parent base or that costs may rise faster than inflation (thus necessitating a larger gap between revenue from

¹⁸³ 55 CONG. REC. 6729 (1917) (quoting *Do Not Penalize Generosity*, BOSTON TRANSCRIPT, June 29, 1917).

tuition and annual budget), government subsidy may be an absolute necessity to keep these schools from forever shutting their doors. It is noteworthy that there is increasing fear about the ability of religious Jewish day schools to continue to support their existing arrangements,¹⁸⁴ and at least one 2009 study projected religious Jewish schools to increase their enrollment by over 30% in the decade between the 2009-10 and the 2018-19 school years,¹⁸⁵ which implies that the support of existing arrangements is becoming increasingly insufficient.

Should religious day schools reach the breaking point and begin to fail, the federal government will likely be precluded by the Establishment Clause (and most state governments by the Blaine Amendments¹⁸⁶) from providing direct assistance to them or to the larger religious community.¹⁸⁷ This fact underscores the need for government subsidy in *advance* of an economic crisis. The schools are not now faltering in large numbers, but if it is in the public's interest to keep them supported, which public policy as expressed in Section 170 would seem to indicate,¹⁸⁸ the public interest demands subsidization before the schools become unstable.

The needs of tax efficiency also counsel for subsidy. A tax system is efficient when it does not distort economic decisions made by private actors. Under an ideal tax system, "individuals and firms [would] make the same decisions in the presence of the tax as they would if the tax did not exist, subject only to the fact that they are less

¹⁸⁴ See, e.g., Prager, *supra* note 126, at 13-14.

¹⁸⁵ SCHICK, *supra* note 140, at 5.

¹⁸⁶ See *supra* note 134.

¹⁸⁷ See *supra* text accompanying notes 53-54.

¹⁸⁸ See *supra* text accompanying notes 15-16.

wealthy by virtue of paying the tax.”¹⁸⁹ The fact that public school education is subsidized and private school education is not lends to precisely the opposite result. Note that my larger argument does not support the conclusion that *all* private education ought to be federally subsidized and I am not now adopting that conclusion. Indeed, some inefficiency is both inevitable and acceptable.¹⁹⁰ The State has an interest in providing affordable education for its citizens and cannot do that if it must cater to every interest group. (Privately funded education is a tool to permit the State to actualize its interests while permitting interest groups to set up their own educational systems as they see fit without state funding.¹⁹¹) That state interest does not extend to creating a system that coerces, however subtly, parents to forgo their religious observance and convictions and send their children into the public system. This is precisely what we saw during the economic downturn at the beginning of this century for 13% of responding religious schools (reporting declining enrollment for reasons of “job loss or financial hardship”).¹⁹² Indeed, a tax system that *discourages* the development of religion and minimizes the public good that religion is able to perform undermines the social policy articulated in Section 170.

Ultimately, permitting charitable deductions for religious parochial school tuition payments will accomplish the ends of subsidy theory: to render socially desirable but economically inefficient transactions more efficient, and thus more likely to take place both during short-term exigencies and over the long-term despite changing

¹⁸⁹ JOINT COMM. ON TAXATION, A RECONSIDERATION OF TAX EXPENDITURE ANALYSIS 53 (2008).

¹⁹⁰ *See id.*

¹⁹¹ *See generally* *Pierce v. Soc’y of Sisters*, 268 U.S. 510 (1925).

¹⁹² *See supra* text accompanying note 167; DOWNTURN, *supra* note 140, at 4, 5.

demographics and economic realities.

VI. CONCLUSION

It has long been assumed that payments for parochial school tuition should not be deductible under Section 170 of the Internal Revenue Code. There is precedent to support those assumptions,¹⁹³ and even Justice O'Connor's strong dissent in *Hernandez* explicitly stated that parochial school tuition is not deductible.¹⁹⁴ However, close analysis of the economics driving parochial education reveals that more is going on in these transactions for education than meets the eye, requiring that we reconsider our long-standing assumptions. The transactions for parochial education are detrimental to the parents, schools, and children and, from purely economic and pedagogical perspectives, should arguably be discouraged. The transactions occur only because they are religious in nature: parents are supporting these institutions because they see them as necessary to the spiritual success of their children and communities. Accordingly, corresponding tuition payments are payments for intangible religious benefits, and ought to be treated no differently than payments for any other intangible religious benefit. Testing this conclusion against probable policy justifications for Section 170 and traditional tax policy analysis suggests further that the "easy case" of parochial school tuition is much harder than previously assumed.

¹⁹³ See generally *Sklar II*, 549 F.3d at 1252; *Sklar I*, 282 F.3d at 610; *Oppewal*, 468 F.2d at 1000; *Winters*, 468 F.2d at 778; *DeJong*, 309 F.2d at 373. The latter three cases might no longer represent good law. See *supra* note 14.

¹⁹⁴ See *supra* text accompanying note 22.