The New York Times

Scientology's Puzzling Journey From Tax Rebel to Tax Exempt

By DOUGLAS FRANTZ

TAXES AND TACTICS

Behind an I.R.S. Reversal

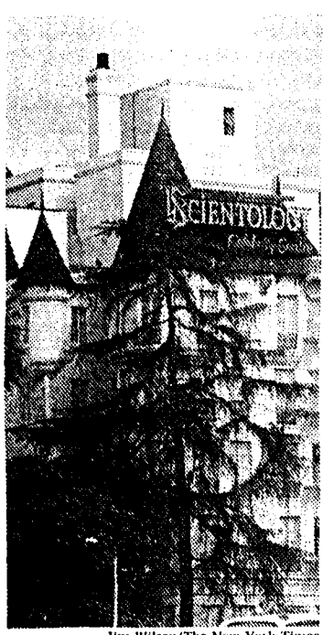
A special report.

On Oct. 8, 1993, 10,000 cheering Scientologists thronged the Los Angeles Sports Arena to celebrate the most important milestone in the church's recent history: victory in its all-out war against the Internal Revenue Service.

For 25 years, I.R.S. agents had branded Scientology a commercial enterprise and refused to give it the tax exemption granted to churches. The refusals had been upheld in every court. But that night the crowd learned of an astonishing turnaround. The I.R.S. had granted tax exemptions to every Scientology entity in the United States.

"The war is over," David Miscavige, the church's leader, declared to tumultuous applause.

The landmark reversal shocked tax experts and saved the church tens of millions of dollars in taxes. More significantly, the decision was an invaluable public relations tool in Scientology's worldwide campaign for acceptance as a mainstream religion. On the basis of the I.R.S. ruling, the State Department formally criticized Germany for discriminating against Scientologists. The German Government regards the organization as a business, not a tax-exempt religion, the very position maintained for 25 years by the American Government.



Jim Wilson/The New York Times

The Church of Scientology's holdings include its Celebrity Center in Los Angeles.

The full story of the turnabout by the I.R.S. has remained hidden behind taxpayer privacy laws for nearly four years. But an examination by The New York Times found that the exemption followed a series of unusual internal I.R.S. actions that came after an extraordinary campaign orchestrated by Scientology against the agency and people who work there. Among the findings of the review by The Times, based on more than 30 interviews and thousands of pages of public and internal church records, were these:

¶Scientology's lawyers hired private investigators to dig into the private lives of I.R.S. officials and to conduct surveillance operations to uncover potential vulnerabilities, according to interviews and documents. One investigator said he had interviewed tenants in buildings owned by three I.R.S. officials, looking for housing code violations. He also said he had taken documents from an I.R.S. conference and sent them to church officials and created a phony news bureau in Washington to gather information on church critics. The church also financed an organization of I.R.S. whistle-blowers that attacked the agency publicly.

¶The decision to negotiate with the church came after Fred T. Goldberg Jr., the Commissioner of the Internal Revenue Service at the time, had an unusual meeting with Mr. Miscavige in 1991. Scientology's own version of what occurred offers a remarkable account of how the church leader walked into I.R.S. headquarters without an appointment and got in to see Mr. Goldberg, the nation's top tax official. Mr. Miscavige offered to call a halt to Scientology's suits against the I.R.S. in exchange for tax exemptions.

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After that meeting, Mr. Goldberg created a special committee to negotiate a settlement with Scientology outside normal agency procedures. When the committee determined that all Scientology entities should be exempt from taxes, I.R.S. tax analysts were ordered to ignore the substantive issues in reviewing the decision, according to I.R.S. memorandums and court files.

The I.R.S. refused to disclose any terms of the agreement, including whether the church was required to pay back taxes, contending that it was confidential taxpayer information. The agency has maintained that position in a lengthy court fight, and in rejecting a request for access by The Times under the Freedom of Information Act. But the position is in stark contrast to the agency's handling of some other church organizations. Both the Jimmy Swaggart Ministries and an affiliate of the Rev. Jerry Falwell were required by the I.R.S. to disclose that they had paid back taxes in settling disputes in recent years.

In interviews, senior Scientology officials and the I.R.S. denied that the church's aggressive tactics had any effect on the agency's decision. They said the ruling was based on a two-year inquiry and voluminous documents that showed the church was qualified for the exemptions.

Mr. Goldberg, who left as I.R.S. Commissioner in January 1992 to become an assistant secretary at the Treasury Department, said privacy laws prohibited him from discussing Scientology or his impromptu meeting with Mr. Miscavige.

The meeting was not listed on Mr. Goldberg's appointment calendar, which was obtained by The Times through the Freedom of Information Act.

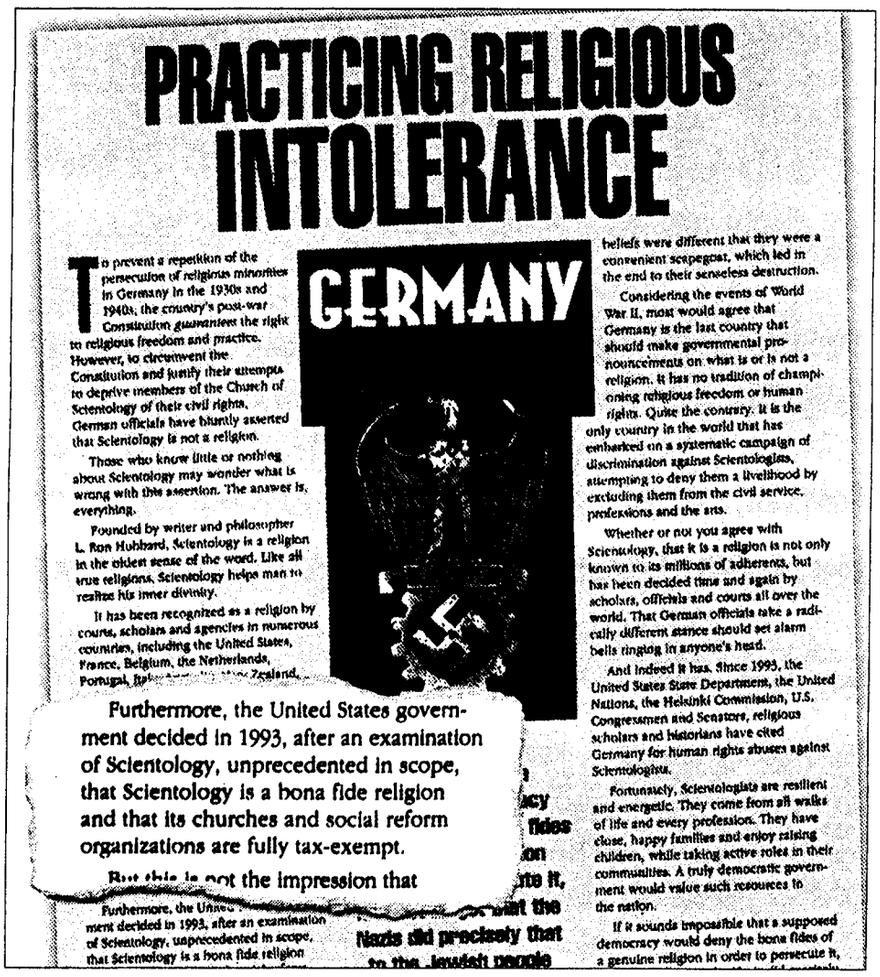
The I.R.S. reversal on Scientology was nearly as unprecedented as the long and bitter war between the organizations. Over the years, the I.R.S. had steadfastly refused exemptions to most Scientology entities, and its agents had focused numerous investigations and audits on the church.

Throughout the battle, the agency's view was supported by the courts. Indeed, just a year before the agency reversal, the United States Claims Court had upheld the I.R.S. denial of an exemption to Scientology's Church of Spiritual Technology, which had been created to safeguard the writings and lectures of L. Ron Hubbard, the late science fiction writer whose preachings form the church's scripture. Among the reasons listed by the court for denying the exemption were "the commercial character of much of Scientology," its "virtually incomprehensible financial procedures" and its "scripturally based hostility to taxation."

Small wonder that the world of tax lawyers and experts was surprised in October 1993 when the I.R.S. announced that it was issuing 30 exemption letters covering about 150 Scientology churches, missions and corporations. Among them was the Church of Spiritual Technology.

"It was a very surprising decision," said Lawrence B. Gibbs, the I.R.S. Commissioner from 1986 to 1989 and Mr. Goldberg's predecessor. "When you have as much litigation over as much time, with the general uniformity of results that the service had with Scientology, it is surprising to have the ultimate decision be favorable. It was even more surprising that the service made the decision without full disclosure, in light of the prior background."

Scientology's Puzzling Trip From Tax Rebel to Tax Exemption



PRACTICING RELIGIOUS INTOLERANCE

GERMANY

To prevent a repetition of the persecution of religious minorities in Germany in the 1930s and 1940s, the country's post-war Constitution guarantees the right to religious freedom and practice. However, to circumvent the Constitution and justify their attempts to deprive members of the Church of Scientology of their civil rights, German officials have bluntly asserted that Scientology is not a religion.

Those who know little or nothing about Scientology may wonder what is wrong with this assertion. The answer is, everything.

Founded by writer and philosopher L. Ron Hubbard, Scientology is a religion in the oldest sense of the word. Like all true religions, Scientology helps man to realize his inner divinity.

It has been recognized as a religion by courts, scholars and agencies in numerous countries, including the United States, France, Belgium, the Netherlands, Portugal, Italy, New Zealand,

beliefs were different that they were a convenient scapegoat, which led in the end to their senseless destruction.

Considering the events of World War II, most would agree that Germany is the last country that should make governmental pronouncements on what is or is not a religion. It has no tradition of championing religious freedom or human rights. Quite the contrary. It is the only country in the world that has embarked on a systematic campaign of discrimination against Scientologists, attempting to deny them a livelihood by excluding them from the civil service, professions and the arts.

Whether or not you agree with Scientology, that it is a religion is not only known to its millions of adherents, but has been decided time and again by scholars, officials and courts all over the world. That German officials take a radically different stance should set alarm bells ringing in anyone's head.

And indeed it has. Since 1995, the United States State Department, the United Nations, the Helsinki Commission, U.S. Congressmen and Senators, religious scholars and historians have cited Germany for human rights abuses against Scientologists.

Fortunately, Scientologists are resilient and energetic. They come from all walks of life and every profession. They have close, happy families and enjoy raising children, while taking active roles in their communities. A truly democratic government would value such resources in the nation.

If it sounds impossible that a supposed democracy would deny the bona fides of a genuine religion in order to persecute it,

Furthermore, the United States government decided in 1993, after an examination of Scientology, unprecedented in scope, that Scientology is a bona fide religion and that its churches and social reform organizations are fully tax-exempt.

But this is not the impression that

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Nazis did precisely that to the Jewish people

THE PUBLICITY CAMPAIGN

In an advertisement the Church of Scientology ran in The New York Times on Oct. 17, the church touted the I.R.S. exemptions and criticized the German Government.

Continued From Page 1

While I.R.S. officials insisted that Scientology's tactics had not affected the decision, some officials acknowledged that ruling against the church would have prolonged a fight that had consumed extensive Government resources and exposed officials to personal lawsuits. At one time, the church and its members had more than 50 suits pending against the I.R.S. and its officials.

"Ultimately the decision was made on a legal basis," said a senior I.R.S. official who was involved in the case and spoke on the condition that he not be identified. "I'm not saying Scientology wasn't taking up a lot of resources, but the decision was made on a legal basis."

The church's tactics appear to violate no laws, and its officials and lawyers argued strenuously in a three-hour interview at church offices in Los Angeles last month that the exemptions had been decided solely on the merits. They said the church had been the victim of a campaign of harassment and discrimination by "rogue agents" within the I.R.S. Once the agency agreed to review the record fairly, they said, it was inevitable that the church would be granted its exemptions. "The facts speak for themselves," said Monique E. Yingling, a Washington lawyer who represented the church in the tax case. "The decision was made based on the information that the church provided in response to the inquiry by the Internal Revenue Service."

Church officials and lawyers acknowledged that Scientology had used investigators to look into their opponents, including I.R.S. officials, but they said the practice had nothing to do with the I.R.S. decision. "This is a church organization that has been subjected to more harassment and more attacks certainly than any religion in this century and probably any religion ever, and they have had to perhaps take unusual steps in order to survive," Ms. Yingling said.

The Origins

An Expanding Church On a Collision Course

Since its founding in 1950, Scientology has grown into a worldwide movement that boasts eight million members, although defectors say the number is much smaller. The church, which has vast real estate holdings around the world and operates a yacht based in the Caribbean, describes itself as the only major new religion to have emerged in the 20th century.

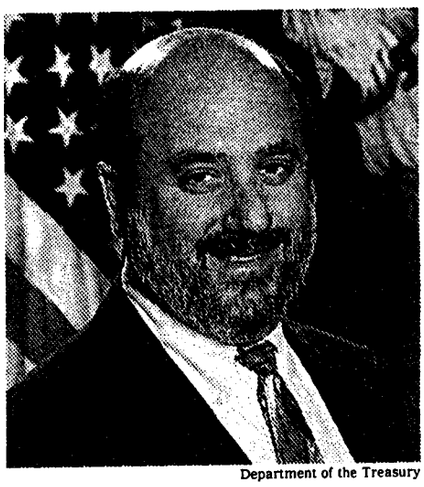
Its founder, Mr. Hubbard, asserted that people are immortal spirits who have lived through many lifetimes. In Scientology teachings, Mr. Hubbard described humans as clusters of spirits that had been trapped in ice and banished to Earth 75 million years ago by Xenu, the ruler of the 26-planet Galactic Confederation.

Scientology describes its goal as "a civilization without insanity, without criminals and without war, where the able can prosper and honest beings can have rights, and where Man is free to rise to greater heights." To reach those heights, Scientologists believe, each individual must be "cleared" of problems and afflictions through a series of counseling sessions known as "auditing." The sessions are performed by a trained auditor assisted by a device similar to a lie detector, known as an E-meter.

Although Scientology's complicated finances make a total estimate difficult, records on file at the I.R.S. indicate that in the early 1990's the church was earning about $300 million a year from auditing fees, the sale of Scientology literature and recordings, management services and the franchising of its philosophy. Church officials said those figures were higher than actual earnings.

The mother church, the Church of Scientology of California, was established by Mr. Hubbard in Los Angeles in 1954. Three years later, it was recognized as tax exempt by the I.R.S. But in 1967, the agency stripped the church of its exemption.

In its revocation letter, the agency said that Scientology's activities were commercial and that it was being operated for the benefit of Mr. Hubbard, a view supported by the courts several times in the ensuing 25 years. The church ignored the action, which it deemed unlawful, and withheld taxes.



Department of the Treasury

THE COMMISSIONER

Fred T. Goldberg Jr. led the I.R.S. when it opened talks with Scientology.

The I.R.S. put Scientology on its hit list. Minutes of I.R.S. meetings indicate that some agents engaged in a campaign to shut down Scientology, an effort that church officials cite as evidence of bias. Some of the tactics led to rebukes by judges, including a 1990 ruling in Boston that criticized the I.R.S. for abusive practices in seeking access to church records.

Scientology retaliated. In 1973 the church embarked on a program code named Snow White. In a document labeled "Secret," Mr. Hubbard outlined a strategy to root out all "false and secret files" held by governments around the world regarding Scientology. "Attack is necessary to an effective defense," Mr. Hubbard wrote.

Snow White soon turned sinister. Under the supervision of Mr. Hubbard's third wife, Mary Sue, Scientologists infiltrated the Department of Justice and the I.R.S. to uncover information on Mr. Hubbard. They broke into offices at night and copied mountains of

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documents. At one point, an electronic bugging device was hidden inside an I.R.S. conference room the day before a meeting about Scientology.

Critics say those actions fell under a church doctrine that Mr. Hubbard called the Fair Game policy. Mr. Hubbard wrote that church enemies might "be deprived of property or injured by any means by any Scientologist without any discipline of the Scientologist. May be tricked, sued or lied to or destroyed."

The conspiracy was uncovered in 1977, and Mrs. Hubbard and 10 others were sentenced to prison. Mr. Hubbard was named an unindicted co-conspirator because investigators could not link him to the crimes.

The church promised to change its ways. Scientologists said that members who had broken the law had been purged, including Mrs. Hubbard, and that the church had been restructured to protect against a recurrence. The Fair Game policy, they said, has been misinterpreted by courts and critics.

"There is nothing like that," said Elliot J. Abelson, the church's general counsel. "It doesn't happen."

The Covert War

Whistle-Blowers And 'Vulnerabilities'

But interviews and an examination of court files across the country show that after the criminal conspiracy was broken up, the church's battle against the I.R.S. continued on other fronts. When Mr. Hubbard died in January 1986, his opposition to taxes lived on among the new generation of leaders, including Mr. Miscavige, a second-generation Scientologist.

Part of the battle was public. A leading role was played by the National Coalition of I.R.S. Whistle-blowers, which Scientology created and financed for nearly a decade.

On the surface, the coalition was like many independent groups that provide support for insiders who want to go public with stories of corruption. But Stacy B. Young, a senior Scientology staff member until she defected in 1989, said she had helped plan the coalition as part of Scientology's battle against the I.R.S. in late 1984 while she was managing editor of the church's Freedom Magazine.

"The I.R.S. was not giving Scientology its tax exemption, so they were considered to be a pretty major enemy," Ms. Young said. "What you do with an enemy is you go after them and harass them and intimidate them and try to expose their crimes until they decide to play ball with you. The whole idea was to create a coalition that was at arm's length from Scientology so that it had more credibility."

Ms. Young said she had recruited Paul J. DesFosses, a former I.R.S. agent who had spoken out against the agency, to serve as the group's president. Mr. DesFosses acknowledged that Scientology had provided substantial financing, but he denied that the church had created or run the coalition. "We got support from lots of church groups, including the Church of Scientology," Mr. DesFosses said in a recent interview.

The coalition's biggest success came in 1989 when it helped spark Congressional hearings into accusations of wrongdoing by I.R.S. officials. Using public records and leaked I.R.S. documents, the coalition showed that a supervisor in Los Angeles and some colleagues had bought property from a company being audited by the agency. Soon after the purchase, the audit was dropped and the company paid no money.

Kendrick L. Moxon, a longtime church lawyer, acknowledged that the coalition had been founded by Freedom Magazine. He said its work was well known and part of a campaign by Scientology and others to reform the I.R.S.

The church's war had a covert side, too, and its soldiers were private investigators. While there have been previous articles about the church's use of private investigators, the full extent of its effort against the I.R.S. is only now coming to light through interviews and records provided to The Times.

Octavio Pena, a private investigator in Fort Lee, N.J., achieved a measure of renown in the late 1980's when he helped expose problems within the I.R.S. while working on a case for Jordache Enterprises, the jeans manufacturer.

In the summer of 1989, Mr. Pena disclosed in an interview, a man who identified himself as Ben Shaw came to his office. Mr. Shaw, who said he was a Scientologist, explained that the church was concerned about I.R.S. corruption and would pay $1 million for Mr. Pena to investigate I.R.S. officials, Mr. Pena said.

"I had had an early experience with the Scientologists, and I told him that I didn't feel comfortable with him, even though he was willing to pay me $1 million," Mr. Pena said.

Scientology officials acknowledged that Mr. Shaw had worked for the church at the time, but they scoffed at the notion that he had tried to hire Mr. Pena. "The Martians were offered $2 million; that's our answer," said Mr. Moxon, whose firm often hired private investigators for the church.

Michael L. Shomers, another private investigator, said he had shared none of Mr. Pena's qualms, at least initially.

Describing his work on behalf of Scientology in a series of interviews, Mr. Shomers said that he and his boss, Thomas J. Krywucki, worked for the church for at least 18 months in 1990 and 1991.

Working from his Maryland office, he said, he set up a phony operation, the Washington News Bureau, so he could pose as a reporter and gather information about church critics. He also said he had infiltrated I.R.S. conferences to gather information about officials who might be skipping meetings, drinking too much or having affairs.

"I was looking for vulnerabilities," Mr. Shomers said.

Mr. Shomers said he had turned over information to his Scientology contact about officials who seemed to drink too much. He also said he had once spent several hours wooing a female I.R.S. official in a bar, then had provided her name and personal information about her to Scientology.

In one instance, information that Mr. Shomers said he had gathered at an I.R.S. conference in the Poconos was turned over to an associate of Jack Anderson, the columnist, and appeared in one of Mr. Anderson's columns criticizing top I.R.S. managers for high living at taxpayers' expense.

Mr. Shomers said he had received his instructions in meetings with a man who identified himself as Jake Thorn and said he was connected with the church. Mr. Shomers said he believed the name was a pseudonym.

Church of Scientology

THE CHURCH LEADER

David Miscavige, Scientology's leader, proposed a deal to end the tax war.

Mr. Shomers said he had looked into several apartment buildings in Pennsylvania owned by three I.R.S. officials. He obtained public files to determine whether the buildings had violated housing codes, he said, and interviewed residents looking for complaints, but found none.

In July 1991, Mr. Shomers said, he posed as a member of the I.R.S. whistle-blowers coalition and worked with a producer and cameraman from NBC-TV to get information about a conference for senior I.R.S. officials in Walnut Creek, Calif. The producer said that she recalled Mr. Shomers as a representative of the whistle-blowers but had known nothing of his connection to Scientology. The segment never ran.

At one point, Mr. Shomers said, he slipped into a meeting room at the Embassy Suites, where the conference was held, and took a stack of internal I.R.S. documents. He said he had mailed the material to an address provided by his church contact.

Mr. Krywucki acknowledged that he had worked for Scientology's lawyers in 1990 and 1991, though he declined to discuss what he had done. He said he would ask the lawyers for permission to speak about the inquiry, but he failed to return telephone calls after that conversation.

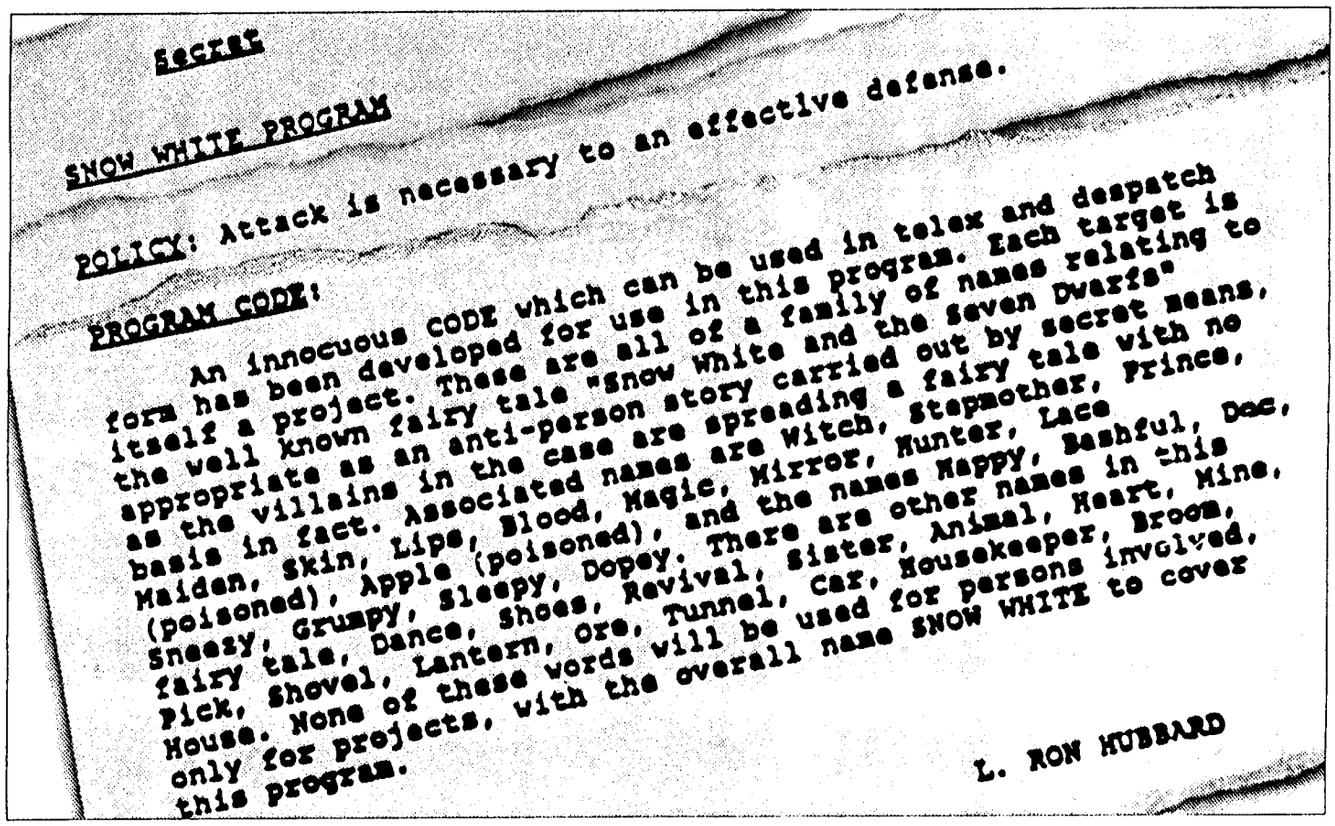
It is impossible to verify all of Mr. Shomers's statements or determine whether his actions were based on specific instructions from church representatives. He said he had often been paid in cash and sometimes by checks from Bowles & Moxon, a Los Angeles law firm that served as the church's lead counsel. He said he had not retained any of the paychecks.

Mr. Shomers provided The Times with copies of records that he said he had obtained for the church as well as copies of hotel receipts showing that he had stayed at hotels where the I.R.S. held three conferences, in Pennsylvania, West Virginia and California. He also provided copies of business cards, with fake names, that he said had been created for the phony news bureau in Washington and copies of photographs taken as part of his surveillance work.

One of the I.R.S. officials investigated by Mr. Shomers recalled that a private investigator had been snooping around properties he managed on behalf of himself and two other midlevel agency officials.

The official, Arthur C. Scholz, who has

TAXES AND TACTICS: Behind an I.R.S. Reversal



Secret

SNOW WHITE PROGRAM

POLICY: Attack is necessary to an effective defense.

PROGRAM CODE:

An innocuous CODE which can be used in telex and despatch form has been developed for use in this program. Each target is itself a project. These are all of a family of names relating to the well known fairy tale "Snow White and the Seven Dwarfs" appropriate as an anti-person story carried out by secret means, as the villains in the case are spreading a fairy tale with no basis in fact. Associated names are Witch, Stepmother, Prince, Maiden, Skin, Lips, Blood, Magic, Mirror, Hunter, Lace (poisoned), Apple (poisoned), and the names Happy, Bashful, Doc, Sneezy, Grumpy, Sleepy, Dopey. There are other names in this fairy tale, Dance, Shoes, Revival, Sister, Animal, Heart, Mine, Pick, Shovel, Lantern, Ore, Tunnel, Car, Housekeeper, Broom, House. None of these words will be used for persons involved, only for projects, with the overall name SNOW WHITE to cover this program.

L. RON HUBBARD

THE DOCUMENT

In 1973 L. Ron Hubbard, the founder of Scientology, outlined a program that was code-named Snow White, through which the church sought to root out "false ideas and secret files" about Scientology among the governments of the world.

since left the I.R.S., said he had been alerted by tenants that a man who identified himself as a private investigator had questioned tenants about him and the other landlords. He said the tenants had not recalled the man's name but had noted that he was driving a car with Maryland license plates.

"He went to the courthouse and found the properties and then went out banging on doors of these tenants and made a number of allegations dealing with things that were totally bull," said Mr. Scholz, who had no involvement with the I.R.S. review of Scientology and was at a loss to explain why the church would have been interested in him. "I notified the local police about it."

Mr. Shomers, who has since left the private-investigation business, said he was willing to describe his work for the church because he had come to distrust Scientology and because of a financial dispute with Mr. Krywucki.

Mr. Moxon, the Scientology lawyer, said the I.R.S. had been well aware of the church's use of private investigators to expose agency abuses when it granted the exemptions. Mr. Moxon did not deny hiring Mr. Shomers, but he said the activities described by Mr. Shomers to The Times had been legal and proper.

Mr. Moxon and other church lawyers said the church needed to use private investigators to counter lies spread by rogue Government agents.

"The I.R.S. uses investigators, too," said a church lawyer, Gerald A. Feffer, a former deputy assistant attorney general now with Williams & Connolly, one of Washington's most influential law firms. "They're called C.I.D. agents" — for Criminal Investigation Division — "and the C.I.D. agents put this church under intense scrutiny for years with a mission to destroy the church."

A blunt assessment of Scientology's victorious strategy against the I.R.S. was contained in a lengthy 1994 article in International Scientology News, an internally distributed magazine. The article said:

"This public exposure of criminals within the I.R.S. had the desired effect. The Church of Scientology became known across the country as the only group willing to take on the I.R.S."

"And the I.R.S. knew it," the article continued. "It became obvious to them that we weren't about to fold up or fade away. Our attack was impinging on their resources in a major way and our exposés of their crimes were beginning to have serious political reverberations. It was becoming a costly war of attrition, with no clear-cut winner in sight."

The Unusual Peace

After a Meeting, A 180-Degree Turn

Scientology made the initial gesture toward a cease-fire when Mr. Miscavige, the church leader, paid an unscheduled visit to the I.R.S. Commissioner, Mr. Goldberg.

The first full account of that meeting and the events that followed inside the I.R.S. was assembled from interviews, Scientology's own internal account, I.R.S. documents and records in a pending suit brought by Tax Analysts, a nonprofit trade publisher, seeking the release of I.R.S. agreements with Scientology and other tax-exempt groups.

Mr. Feffer, a church lawyer since 1984, said he approached officials at the Justice Department and the I.R.S. in 1991 with an offer to negotiate an end to the dispute.

The church's version of what followed is quite remarkable. Mr. Miscavige and Marty Rathbun, another church official, were walking past the I.R.S. building in Washington with a few hours to spare one afternoon in late October 1991 when they decided to talk to Mr. Goldberg.

After signing the visitor's log, the two men asked to see the Commissioner. They told the security guard that they did not have an appointment but were certain Mr. Goldberg would want to see them. And, according to the church account, he did.

Scientology's Puzzling Trip From Tax Rebel to Tax Exemption

Mr. Goldberg said he could not discuss the meeting, although a former senior official confirmed that it had occurred. An I.R.S. spokesman said it would be unusual for someone to meet with the Commissioner without an appointment.

Mr. Miscavige does not grant interviews, church officials said, but Mr. Rathbun said the Goldberg meeting had been an opportunity for the church to offer to end its long dispute with the agency, including the dozens of suits brought against the I.R.S., in exchange for the exemptions that Scientology believed it deserved.

"Let's resolve everything," Mr. Rathbun recalled saying. "This is insane. It's reached insane levels."

Mr. Goldberg's response was also out of the ordinary. He created a special five-member working group to resolve the dispute, bypassing the agency's exempt organizations division, which normally handles those matters. Howard M. Schoenfeld, the I.R.S. official picked as the committee's chairman in 1991, said later in a deposition in the Tax Analysts case that he recalled only one similar committee in 30 years at the agency.

The I.R.S. negotiators and Scientology's tax lawyers held numerous meetings over nearly two years. An I.R.S. official who participated, and who spoke about the meetings on the condition that his name not be used, described the sessions as occasionally rancorous, but he said the general tone had been far friendlier than over the preceding years.

There are indications that the early momentum was toward resolution. In a letter to Ms. Yingling on Jan. 19, 1992, John E. Burke, the assistant commissioner for exempt organizations, brushed aside what could have been a stumbling block. Ms. Yingling had apparently objected to the potential public disclosure of information that the church was providing to the I.R.S.

Mr. Burke said he did not want the dispute to delay the talks, and he committed the I.R.S. to allowing only a portion of the information to become public. He said the only hitch would come "in the event that our discussions break down, an eventuality that I have no reason to believe will occur."

An I.R.S. official involved in the talks said it was not unusual for the agency to negotiate with a taxpayer over what is made public in an agreement. By agreeing at the outset that information could be withheld, however, the I.R.S. seemed to relinquish a big bargaining chip.

Paul Streckfus, a former official in the I.R.S. exempt organization division, first disclosed the existence of the negotiating committee in a trade journal after the agreement was announced. He said in an interview that creating the group had meant a settlement had almost been preordained.

"Once the I.R.S. decided to set up this rather extraordinary group, the wheels were in motion for a deal," Mr. Streckfus said.

Not even a stinging court decision in favor of the I.R.S. could derail the talks. Midway through the negotiations, in June 1992, the United States Claims Court handed down its decision upholding the I.R.S. denial of a tax exemption for Scientology's Church of Spiritual Technology.

Ms. Yingling, the church's tax lawyer, said the Claims Court ruling ignored the facts and was filled with gratuitous comments. She said the I.R.S. negotiators were fairer in considering the evidence.

A portion of the correspondence between the agency and church from the two years of negotiations was released when the exemptions were granted three and a half years ago. It fills part of a large bookcase in the I.R.S. reading room in Washington.

The central issues are discussed in a series of lengthy answers by Scientology's lawyers to questions from the I.R.S. The church provided extensive information on its finances and operational structure.

Church of Scientology

THE COUNSELING

Scientology counseling sessions use a device known as an E-meter.

The senior I.R.S. official involved in the negotiations, who asked not to be identified, said the church had satisfied the agency in three critical areas. He said the committee was persuaded that those involved in the Snow White crimes had been purged, that church money was devoted to tax-exempt purposes and that, with Mr. Hubbard's death, no one was getting rich from Scientology.

Ms. Yingling argued that nothing substantive had changed. She said the church had been qualified for tax exemption for years, but biased elements within the I.R.S. had stood in its way. "There were no changes in the operations or activities of the church," she said. "What came about was finally that they looked at all the information and saw that the church qualified for exemption, and they were satisfied."

In August 1993, the two sides reached an agreement. The church would receive its coveted exemptions for every Scientology entity in the country and end its legal assault on the I.R.S. and its personnel.

There was just one more step. Scientology entities were required to submit new applications for exemption, which were to be evaluated by the agency's exempt organizations division. But something unusual occurred there, too.

Mr. Schoenfeld, the negotiations chairman, ordered the two tax analysts assigned to the review not to consider any substantive matters, according to I.R.S. memorandums and records in the Tax Analysts case. Those issues, Mr. Schoenfeld informed them, had been resolved.

Both analysts, Donna Moore and Terrell M. Berkovsky, wrote memorandums specifying that they had been instructed not to address issues like whether the church was engaged in too much commercial activity or whether its activities provided undue private benefit to its leaders.

Mr. Schoenfeld, who has since left the I.R.S., said he could not discuss the case. However, the senior I.R.S. official involved in the talks said there had been nothing sinister about the instructions because those matters had been decided by the negotiating committee. He acknowledged, however, that this was not the typical procedure.

The agreement was announced on Oct. 13, 1993. The I.R.S. refused to make public any of its terms, including whether the church paid

The New York Times

THE NEW YORK TIMES NATIONAL SUNDAY, MARCH 9, 1997

any back taxes. The I.R.S. also refused to discuss the legal reasoning behind one of the biggest turnarounds in tax history.

Tax lawyers said the I.R.S. could have required the church to disclose terms of the agreement, as it has done in the past. In 1991, the I.R.S. required the Jimmy Swaggart Ministries to disclose that the group had paid $171,000 in back taxes for violations. In 1993, just a few months before the Scientology agreement, the I.R.S. required the Old Time Gospel Hour, a group affiliated with the Rev. Jerry Falwell, to publicize its payment of $50,000 in back taxes.

"The I.R.S. actually specified which media outlets we were to notify and approved the release," said Mark DeMoss, a spokesman for Mr. Falwell. "When nobody picked it up, they put out their own press release."

William J. Lehrfeld, who represents Tax Analysts in its suit to make the Scientology agreement public, said, "You and I, as taxpayers, are subsidizing these people, and we should see this information."

The Aftermath

A Former Enemy Becomes an Ally

Five days before the official announcement, Mr. Miscavige went before the Scientology gathering in Los Angeles and declared victory. In a two-hour speech, according to the account in International Scientology News, Mr. Miscavige described years of attacks against Mr. Hubbard and Scientology by the Government.

"No other group in the history of this country has ever been subject to the assault I have briefed you on tonight," he said, calling it "the war to end all wars."

As part of the settlement, Mr. Miscavige said, the I.R.S. had agreed to distribute a fact sheet describing Scientology and Mr. Hubbard. "It is very complete and very accurate," Mr. Miscavige said. "Now, how do I know? We wrote it! And the I.R.S. will be sending it out to every government in the world."

Mr. Feffer, Ms. Yingling and Thomas C. Spring, another of the church's tax lawyers, appeared in formal attire on stage that night and received Waterford crystal trophies in recognition of their efforts.

Mr. Miscavige called the agreement a peace treaty that would mark the biggest expansion in Scientology history.

The church immediately began citing the I.R.S. decision in its efforts to win acceptance from other governments and silence critics. But the biggest public relations benefit may have come from the American Government itself.

Four months after the exemptions were granted, the State Department released its influential human rights report for 1993, a litany of the countries that abuse their citizens. For the first time, the report contained a paragraph noting that Scientologists had complained of harassment and discrimination in Germany. The matter was mentioned briefly in the 1994 and 1995 reports, too.

Throughout those years, the dispute between Scientologists and the German Government escalated. In an intense publicity campaign that included advertisements in this newspaper, the church said that businesses owned by Scientologists had been boycotted and that its members had been excluded from political parties and denied access to public schools. The church asserted that the German actions paralleled the early Nazi persecution of Jews.

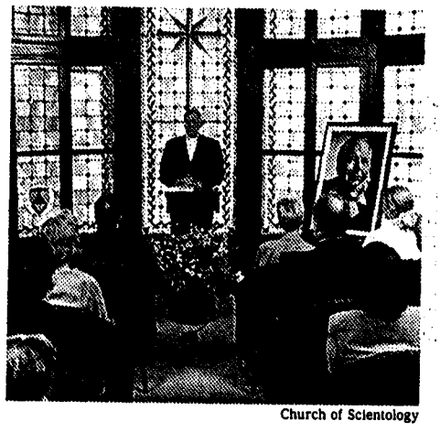
The German Government responded that Scientology was not a church worthy of tax exemption, but a commercial enterprise — the very position the I.R.S. had maintained in its 25-year war against the church. German officials said equating the treatment of Scientologists with that of Jews under the Nazi regime was a distortion and an insult to victims of the Holocaust, a view supported by some Jewish leaders in Germany.

The dispute turned into a diplomatic ruckus in January when the State Department released its 1996 human rights report, with an expanded section on Scientology that said German scrutiny of the religion had increased. Artists had been prevented from performing because of their membership in the church and the youth wing of the governing Christian Democratic Union had urged a boycott of the film "Mission: Impossible" because its star, Tom Cruise, is a prominent Scientologist, the State Department said.

German officials were angered by the criticism, and Foreign Minister Klaus Kinkel raised the matter with Secretary of State Madeleine K. Albright when she was in Bonn on Feb. 18. Ms. Albright told him that the issue was a subject for bilateral discussions, but she said she found claims by Scientologists that they are the victims of Nazi-style persecution "distasteful."

Nicholas Burns, the State Department spokesman, said that, despite the belief that Scientologists had gone too far in drawing comparisons to persecution of Jews, the department had felt compelled to expand on the church's troubles with the Germans in its latest human rights report.

"The Germans are quite adamant, based on their own history, that these are the kinds of groups that ought to be outlawed," Mr. Burns said. "However, for our purposes, we classify Scientology as a religion because they were granted tax-exempt status by the American Government."



Church of Scientology

THE FOUNDING CHURCH

A service at the original Scientology church in Washington, D.C.

Scientology's Puzzling Journey From Tax Rebel to Tax Exempt

By DOUGLAS FRANTZ

Church vs. State

1950's

1954 The Church of Scientology of California is established by L. Ron Hubbard, a prolific science fiction writer whose preachings form the church's scripture.

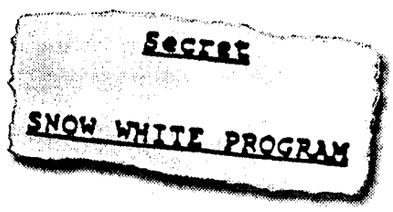
JAN. 2, 1957 The Internal Revenue Service grants a tax exemption to the Church of Scientology of California.

1960's

JULY 18, 1967 After an audit, the I.R.S. revokes the church's tax exemption, saying that the church's activities were commercial and that it was servicing the private interests of Mr. Hubbard and other practitioners.

1970's

APRIL 28, 1973 Scientology implements a secret program, code named Snow White, in an effort to root out and remove false files about the church and Mr. Hubbard held by governments around the world.



JULY 7, 1977 F.B.I. raids on Scientology's world headquarters in Los Angeles and offices in Washington discover evidence that its members conspired to infiltrate, burglarize and bug offices of the I.R.S. and Justice Department. A 19-page document seized outlined a plan to sabotage IRS investigations. Eleven Scientologists, including Mr. Hubbard's wife, Mary Sue, eventually went to prison.

1980's

LATE 1984 Stacy B. Young, a Scientology defector, says that she helped create the National Coalition of I.R.S. Whistle-blowers to undermine the agency's credibility. The group's president, Paul J. DesFosses, says Scientology provided substantial financing, but denies that the church ran the group, which helped fuel Congressional hearings in 1989 into accusations of corruption at the I.R.S.

1990's

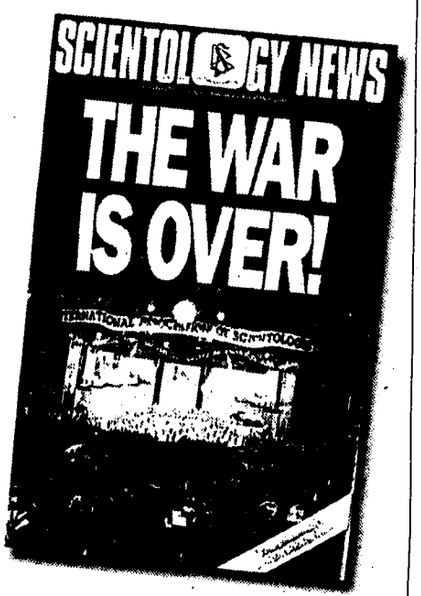
1990-91 Michael L. Shomers, a former private investigator, says he and a partner investigated I.R.S. officials on behalf of the church, looking for vulnerabilities.

LATE OCT. 1991 David Miscavige, widely regarded as the leader of the Church of Scientology, has an unusual unscheduled meeting with Fred T. Goldberg Jr., the Commissioner of the I.R.S. Mr. Miscavige offers to negotiate an end to the hostilities. Soon after, Mr. Goldberg appoints a five-person negotiating group to reach a settlement with Scientology.

AUG. 13, 1993 The I.R.S. agrees to grant tax exemptions to every Scientology entity in the United States. The church files new applications for exemption as part of the agreement.

SEPT. 10-14, 1993 Two I.R.S. tax analysts write internal memorandums saying that they have been instructed to ignore substantive issues in reviewing the new Scientology applications.

OCT. 8, 1993 Mr. Miscavige tells 10,000 cheering members in Los Angeles that the exemptions have been granted. "The war is over," he declares.



OCT. 13, 1993 In Washington, the I.R.S. announces exemptions for about 150 Scientology entities, ending its 25-year battle with the church.