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RELIGIOUS LIBERTY AND CHARITABLE DONATIONS PROTECTION ACT OF 1997; AND RELIGIOUS FAIRNESS IN BANKRUPTCY ACT OF 1997

THURSDAY, FEBRUARY 12, 1998
House of Representatives,
Subcommittee on Commercial and Administrative Law,
Committee on the Judiciary,
Washington, DC.

The subcommittee met, pursuant to notice, at 10:00 a.m., in room 2237, Rayburn House Office Building, Washington, D.C., Hon. George W. Gekas (chairman of the subcommittee) presiding.

Present: Representatives Ed Bryant, Steve Chabot, Sheila Jackson Lee, and Martin T. Meehan,

Also present: Raymond V. Smietanka, chief counsel, Subcommittee on Commercial and Administrative Law; Susan Jensen-Conklin, counsel, Audray Clement, staff assistant; David Lachmann, professional staff member, Committee on the Judiciary.

OPENING STATEMENT OF CHAIRMAN GEKAS

Mr. **GEKAS.** The hour of ten o'clock has arrived and the subcommittee will come to order. The normal procedure is for us to await the arrival of a second member of the subcommittee. Pardon me, I see the gentlelady from Texas is here. A quorum for the purpose of the hearing is present, and we will commence with the consideration of today's issue, which is, as everyone knows by now, the issue within the bankruptcy arena of the contributions made to charitable organizations, churches, and others, which for one reason or another, become involved in the bankruptcy process. The bankruptcy trustees and the courts have in the past considered a charitable contribution no less or no more than any other kind of asset which they would feel within their purview to seize and to make a part of the debtor's estate for distribution either under Title VII or Title XIII of the Bankruptcy Code. This has driven many individuals and many organizations and members of Congress as well to the thought of considering whether or not these charitable contributions should be exempted from the aegis of the bankruptcy process.

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In that regard both in the Senate and in the House, we have had colleagues introduce spearhead legislation in this regard, and two of the members from the House are here today, and we will invite them to the witness table to begin the process.

Senator Grassley is here. Why don't you, Senator, and the two members join us at the witness table? We will forego opening statements from the members for the purpose of expediting the schedules of both Senator Grassley and our colleagues in the House, and we will begin promptly with Senator Grassley to make his opening statement.

Senator Grassley.

STATEMENT OF CHARLES E. GRASSLEY, A U.S. SENATOR FROM THE STATE OF IOWA, AND CHAIRMAN OF THE SENATE JUDICIARY SUBCOMMITTEE ON ADMINISTRATIVE OVERSIGHT AND THE COURTS

Mr. **GRASSLEY.** First of all, if I can congratulate you on starting a hearing on time, I really appreciate that, and this is the first time I have been invited to the House to testify at a certain time that I have been able to do it. Thank

you very much.

Obviously, I appreciate the invitation and more importantly, appreciate your interest in this issue of bankruptcy and tithing. Obviously, we are here because religious liberty is one of our most priceless freedoms, and Congress has to be diligent to make sure that the bankruptcy courts do not use the Bankruptcy Code to infringe on the religious freedom of the American people.

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That is why I introduced S. 1244, which I have entitled The Religious Liberty and Charitable Donations Protection Act. This bill will protect churches from being sued by bankruptcy trustees to recover tithes and to permit debtors in Chapter XIII to tithe during the course of their repayment plan.

As you know, Mr. Chairman, my bill protects donations to churches, but also other types of nonprofit charities. Now, this is necessary because many well-respected constitutional scholars believe that protecting only religiously motivated donations from the reach of the Bankruptcy Code would violate the Establishment Clause of the First Amendment.

This morning as we sit here, the Senate Judiciary Committee has put this bill on the agenda for a mark-up, and it is customary in our committee on the other side for bills to be delayed for one week or until the next hearing once they appear on the agenda. I expect 1244 out of committee at our next mark-up, which should be right after recess.

I think it appropriate for you, Mr. Chairman, to begin your hearings in the bankruptcy reform on this important issue which has such broad support.

As you well know, we have a lot of bankruptcy reform issues to consider this year, and there may be many areas of disagreement between the House and Senate, and between Republicans and Democrats, so it is good that Congress is coming together on this topic early in the bankruptcy reform process.

The bill I introduced in the Senate and the one which Congressman Packard has introduced here in the House should pass quickly, and hopefully, this will show the American people that Congress can confront a problem and act together to protect the constitutional rights of the American people.

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In my view, Mr. Chairman, when the Supreme Court struck down the Religious Freedom Restoration Act as unconstitutional, that decision had an impact upon the dealing with here. Our nation took a giant step backward once again in a fit of judicial activism, even a more conservative Supreme Court has derailed the legislative process and thwarted participatory democracy. Congress has to act quickly.

When I chaired a hearing on this subject before my subcommittee late last year, I heard from the pastor of Crystal Free Evangelical Church. As you know, Mr. Chairman, this church is a church which is fighting right now in the Eighth Circuit Court of Appeals in St. Louis to keep the bankruptcy court out of its church coffers.

Pastor Goold testified in a very compelling way about the practical difficulties his church has faced because of the Bankruptcy Code. As Pastor Goold put it, when there is a conflict between the bankruptcy laws and the laws of God, we should change the bankruptcy laws because God's laws aren't going to change.

Whether you believe in tithing or not, and of course, I do believe in tithing as biblically mandated, it is clear that many American feels that tithing is an act of worship required by divine law. It is completely unacceptable then to have the Bankruptcy Code undo this act of worship.

The legislation I have introduced will prevent this from happening, and Congress ought to pass it right away.

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Finally, I would like to address a concern that I have heard raised about my legislation. First, the bill does not amend section 548(a)(1) of the Bankruptcy Code. This section lets bankruptcy courts recover any transfer of assets on the eve of bankruptcy if the transfer was made to delay or hinder a creditor. Therefore, if the bill is enacted, we don't have to worry about a sudden rash of charitable giving in anticipation of bankruptcy. Such transfers would obviously be for the purpose of hindering creditors and would still be subject to the bankruptcy judge's powers. In other words, there really isn't much room for abuse as a result of my legislation.

Mr. Chairman, you are to be commended for having this hearing, and I would urge you and your subcommittee to move quickly on this legislation.

[The prepared statement of Mr. Grassley follows:]

PREPARED STATEMENT OF CHUCK GRASSLEY, A U.S. SENATOR FROM THE STATE OF IOWA, AND CHAIRMAN OF THE SENATE JUDICIARY SUBCOMMITTEE ON ADMINISTRATIVE OVERSIGHT AND THE COURTS

MR. CHAIRMAN, I'M PLEASED TO BE ABLE TO APPEAR BEFORE THIS SUBCOMMITTEE TO GIVE MY THOUGHTS CONCERNING BANKRUPTCY AND TITHING. RELIGIOUS LIBERTY IS ONE OF OUR MOST PRECIOUS FREEDOMS, AND CONGRESS HAS TO BE DILIGENT IN MAKING SURE THAT THE BANKRUPTCY COURTS DO NOT USE THE BANKRUPTCY CODE TO INFRINGE ON THE RELIGIOUS FREEDOM OF THE AMERICAN PEOPLE. THAT'S WHY I INTRODUCED S. 1244 "THE RELIGIOUS LIBERTY AND CHARITABLE DONATIONS PROTECTION ACT."

THIS BILL WILL PROTECT CHURCHES FROM BEING SUED BY BANKRUPTCY TRUSTEES TO RECOVER TITHES AND PERMITS DEBTORS IN CHAPTER 13 TO TITHE DURING THE COURSE OF THEIR REPAYMENT PLAN. NOW, MY BILL PROTECTS DONATIONS TO CHURCHES AS WELL AS OTHER TYPES OF NON–PROFIT CHARITIES. I DID THIS BECAUSE MANY WELL–RESPECTED CONSTITUTIONAL SCHOLARS BELIEVE THAT PROTECTING ONLY RELIGIOUSLY–MOTIVATED DONATIONS FROM THE REACH OF THE BANKRUPTCY CODE WOULD VIOLATE THE ESTABLISHMENT CLAUSE OF THE FIRST AMENDMENT.

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THIS MORNING, THE SENATE JUDICIARY COMMITTEE HAS PUT THIS BILL ON THE AGENDA FOR OUR MARK–UP, WHICH IS GOING ON RIGHT NOW. SINCE BILLS ARE CUSTOMARILY HELD OVER THE FIRST TIME THEY ARE ON THE COMMITTEE'S AGENDA, I EXPECT THAT THE SENATE JUDICIARY COMMITTEE WILL PASS S. 1244 OUT OF COMMITTEE AT OUR NEXT MARK–UP, WHICH WILL OCCUR RIGHT AFTER THE RECESS.

I THINK THAT IT'S APPROPRIATE FOR YOU, MR. CHAIRMAN, TO BEGIN YOUR HEARINGS INTO BANKRUPTCY REFORM ON THIS IMPORTANT ISSUE WHICH HAS SUCH BROAD SUPPORT. AS YOU WELL KNOW, WE HAVE A LOT OF BANKRUPTCY REFORM ISSUES TO CONSIDER THIS YEAR, AND THERE MAY BE MANY AREAS OF DISAGREEMENT BETWEEN THE HOUSE AND SENATE AND BETWEEN REPUBLICANS AND DEMOCRATS. SO, IT'S GOOD THAT CONGRESS IS COMING TOGETHER AROUND THIS TOPIC EARLY IN THE BANKRUPTCY REFORM PROCESS. THE BILL I INTRODUCED IN THE SENATE, AND THE ONE WHICH CONGRESSMAN PACKARD HAS INTRODUCED HERE IN THE HOUSE, SHOULD PASS QUICKLY. AND I HOPE THIS WILL SHOW THE AMERICAN PEOPLE THAT CONGRESS CAN CONFRONT A PROBLEM AND ACT TOGETHER TO PROTECT THE CONSTITUTIONAL RIGHTS OF THE AMERICAN PEOPLE.

IN MY VIEW, MR. CHAIRMAN, WHEN THE SUPREME COURT STRUCK DOWN THE RELIGIOUS FREEDOM RESTORATION ACT AS UNCONSTITUTIONAL, OUR NATION TOOK A GIANT STEP BACKWARD. ONCE AGAIN, IN A FIT OF JUDICIAL ACTIVISM, THE SUPREME COURT HAS DERAILED THE LEGISLATIVE PROCESS AND THWARTED DEMOCRACY. CONGRESS HAS TO ACT QUICKLY.

WHEN I CHAIRED A HEARING ON THIS SUBJECT BEFORE MY SUBCOMMITTEE LATE LAST YEAR, I HEARD FROM THE PASTOR OF CRYSTAL FREE EVANGELICAL CHURCH. AS YOU MAY KNOW, MR. CHAIRMAN, THIS CHURCH IS THE CHURCH WHICH IS FIGHTING RIGHT NOW IN THE 8TH CIRCUIT COURT OF APPEALS TO KEEP THE BANKRUPTCY COURT OUT OF ITS CHURCH COFFERS. PASTOR GOOLD TESTIFIED IN A VERY COMPELLING WAY ABOUT THE PRACTICAL DIFFICULTIES HIS CHURCH HAS FACED BECAUSE OF THE BANKRUPTCY CODE. AS PASTOR GOOLD PUT IT, WHEN THERE'S A CONFLICT BETWEEN THE BANKRUPTCY LAWS AND THE LAWS OF GOD, WE SHOULD CHANGE THE BANKRUPTCY LAWS BECAUSE GOD'S LAWS AREN'T GOING TO CHANGE.

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WHETHER YOU BELIEVE IN TITHING OR NOT—AND I BELIEVE THAT TITHING IS BIBLICALLY–MANDATED—IT'S CLEAR THAT MANY AMERICANS FEEL THAT TITHING IS AN ACT OF WORSHIP, REQUIRED BY DIVINE LAW. IT'S COMPLETELY UNACCEPTABLE TO HAVE THE BANKRUPTCY CODE UNDO AN ACT OF WORSHIP. THE LEGISLATION I'VE INTRODUCED WILL PREVENT THIS FROM HAPPENING AND CONGRESS OUGHT TO PASS IT RIGHT AWAY.

FINALLY, I WOULD LIKE TO ADDRESS A CONCERN IRE HEARD RAISED ABOUT THE LEGISLATION. FIRST, THE BILL DOESN'T AMEND SECTION 548(A)(1) OF THE BANKRUPTCY CODE. THIS SECTION LETS BANKRUPTCY COURTS RECOVER ANY TRANSFER OF ASSETS ON THE EVE OF BANKRUPTCY IF THE TRANSFER WAS MADE TO DELAY OR HINDER A CREDITOR. THEREFORE, IF THE BILL IS ENACTED, WE DON'T HAVE TO WORRY ABOUT A SUDDEN RASH OF CHARITABLE GIVING IN ANTICIPATION OF BANKRUPTCY. SUCH TRANSFERS WOULD OBVIOUSLY BE FOR THE PURPOSE OF HINDERING CREDITORS AND WOULD STILL BE SUBJECT TO A BANKRUPTCY JUDGE'S POWER. IN OTHER WORDS, THERE REALLY ISN'T MUCH ROOM FOR ABUSE HERE.

MR. CHAIRMAN, YOU ARE TO BE COMMENDED FOR HAVING THIS HEARING AND I WOULD URGE YOU AND YOUR SUBCOMMITTEE TO MOVE THIS LEGISLATION WITH DISPATCH.

Mr. **GEKAS.** Thank you very much, Senator Grassley. We have come to a point where we can excuse the Senator so he can return to his duties. We will recess now so that the members can return to or go to the floor for the pendency of the vote now on the board, unless either member wishes to say here, forego that vote. I would do the same to hear that testimony. It is up to you. It is a general vote.

Do you want to return to the House for that purpose?

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Mr. **PACKARD.** It is your call, Mr. Chairman. It doesn't matter.

Ms. **JACKSON-LEE.** Mr. Chairman.

Mr. **GEKAS.** Do you want to go to the floor?

Ms. **JACKSON-LEE.** I do, and I need to be on the floor, so I just wanted 30 seconds, and I will try to return, but I need to go to the floor.

Mr. **GEKAS.** All right. Then we will recess.

Ms. **JACKSON-LEE.** I would like to speak before we recess because I may not be able to return before they leave.

Mr. **GEKAS.** The lady is recognized.

Ms. **JACKSON-LEE.** Let me, because I am on the Democratic side, indicate my great enthusiasm for this legislation. I know that there has been a lot of concerns raised, and I believe that as the legislation proceeds, any questions can be answered. But I do believe the First Amendment and religious liberty are certainly incorporated in the legislation that you have present. I look forward to its programs, and I think the American people will appreciate that we have taken the bankruptcy laws and responding to the great need of charities and of religion. Thank you very much. I yield back, Mr. Chairman.

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Mr. **GEKAS.** Prudence dictates that we recess and reconvene at 10:25. We are now recessed until 10:25.

[Recess]

Mr. **GEKAS.** The subcommittee will come to order. The witnesses at the witness table are two of our colleagues who have taken a substantial interest in the progress of the issue at hand. Both of them have introduced legislation. Both of the bills are part of the package which we will be considering. I might say to both Ron and Helen that in the overall bankruptcy reform measure that we are formulating, I will do everything I can to try to incorporate this issue into the overall system which we plan to produce in our comprehensive bill. One way or another, there will be action on this bill during this session.

With that, why don't we start with the Honorable Helen Chenoweth, who has produced a bill on which we ask her now to give us a summary.

STATEMENT OF HON. HELEN CHENOWETH, A REPRESENTATIVE IN CONGRESS FROM THE STATE OF IDAHO

Mrs. **CHENOWETH.** Thank you, Mr. Chairman. I would like to express my appreciation to the subcommittee members and the staff for the opportunity to testify on behalf of H.R. 2611, my Religious Fairness in Bankruptcy Act, and Mr. Packard's Religious Liberty and Charitable Donation Protection Act.

This is a timely and crucial issue for churches across the county who have found their financial survival threatened. It also affects those who attend churches or synagogues or any house of worship and find their ability to fulfill their religious duties questioned.

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My home state, Idaho, has seen churches subjected to the disgorgement of debtors' tithes from their already tight funds. Both the Magic Valley Evangelical Free Church and Broadway Avenue Baptist Church in Idaho have been forced to surrender tithed monies that had been spent long before the trustee decided to pursue those funds. Often, these churches operate on a week-to-week basis and are unable to set aside large sums in the event that one of their parishioners may declare bankruptcy.

The time to bring an end to this misapplication of the Bankruptcy Code is now. The right to free exercise of religious is a fundamental liberty expressed in our Constitution, and religious freedom must be protected.

What is happening to our churches represents a serious threat to those who follow the dictates of their conscience and the framework of their religious beliefs. Many give a portion of their income as tithes to their religious institution, some based on faith, others based on scriptures, others based on religious obligation. I think you will agree that our

nation's foundations clearly were not based on the notion of depriving her citizens of their religious freedom in this way.

I introduced the Religions Fairness and Bankruptcy Act to combat this problem directly. My bill grants that tithes will be considered to be a transaction involving an exchange of "reasonably equivalent value." This balanced approach addresses both the need for tithes to be protected and the importance of ensuring that creditors be allowed to collect the money legitimately owed them.

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There are two primary concerns which must be key components of legislation to address this problem.

First, it must be stressed that the concept of protecting tithes to churches and religious institutions has firm constitutional standing. As we will hear from later expert constitutional witnesses, there is no need to connect churches to 501(c)(3) groups in order to pass constitutional muster.

Any attempt to combine churches with nonprofit 501(c)(3) groups, no matter how well intentioned, could result in the subjugation of churches to further governmental regulations down the road. To date, no nonprofit group—let me repeat that—to date, no nonprofit group has been subject to the same treatment as churches under the Bankruptcy Code, so their inclusion solves a nonexistent problem. Making this connection only serves to start us down the slippery slope of government regulation of our churches.

I recognize that the motive is to pass constitutional muster; however, this inclusion is not necessary. The Supreme Court has on numerous occasions rejected the argument that exemptions for religious activities are unconstitutional if not extended to secular activities.

Indeed, the Supreme Court stated in a case entitled *Corporation of Presiding Bishop* v. *Amos* in 1987 that ". . . the government may and sometimes must accommodate religious practices and that it may do so without violating the Establishment Clause." The protection of constitutional rights serves a social, secular purpose, not a religious one. I don't profess to be an expert in constitutional law, but the subcommittee will hear from experts who do agree.

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The second area of major importance is the definition of tithes. The government should not be in the business of attempting to do what only the scriptures should do and has done. Assigning any numeric value or cap to tithes puts the autonomy of religion in danger through Government control. I believe we should be very leery of any language that would attempt to attach a figure to a tithe. As members of Congress, we have the authority to rewrite the laws, but we cannot and should not attempt to rewrite scripture. Scripture defines tithes, not the federal government.

In determining the legitimacy of fund transfers, the tests of giving patterns in history should continue to be applied so as to protect the giver's free exercise rights. This should be balanced by language allowing the trustee the discretion to determine intent to defraud. My bill makes room for both of those components.

Finally, I would add that it is crucial in determining action on any legislation that we ask ourselves, "what is the right thing to do?" Not "what is the most politically expedient thing to do?"

A solution that would include nonprofit groups may sound both politically and rhetorically attractive. However, I believe there is a very clear problem facing our nation's churches and churchgoers, and there is a very clear answer to dealing with it. My Religious Fairness in Bankruptcy Act provides a lucid solution to this unjust intrusion into this religious exercise. 501(c)(3) organizations are a creation of the state; churches are not. H.R. 2611 is the best approach to specifically address the invasion of religious freedom in our nation's churches, and it is the right thing to do.

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It is important that the doctrine of the separation of church and state be kept intact. Any challenges to this legislation under the Establishment Clause will be unsuccessful. The type of exemption included in H.R. 2611 is wholly constitutional as you will hear from other witnesses today, and it does not present Establishment Clause conflicts. The components of H.R. 2611 are consistent with the Supreme Court's rulings in recent cases dealing with religious freedoms.

Formulating a solution to a problem that doesn't exist would only exacerbate the already rising problem of bankruptcy and debt that our nation has been faced with in the last decade. Let us stick to the task at hand and address separate issues in separate legislation.

Again, I would like to thank you, Chairman Gekas, Ranking Member Nadler, who is not here, but I do thank his staff, and the members of the committee for the opportunity to address this body and for the work of both yourself and the staff in preparing this hearing.

I would also like to thank Mr. Grassley and Mr. Packard for their very hard work in defending the rights of Americans to practice their religious beliefs.

Again, thank you, Mr. Chairman, and I look forward to working with you in ensuing the passage of an effective piece of legislation that will provide a solution to this growing problem.

[The prepared statement of Mrs. Chenoweth follows:]

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PREPARED STATEMENT OF HON. HELEN CHENOWETH, A REPRESENTATIVE IN CONGRESS FROM THE STATE OF IDAHO

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My home state, Idaho, has seen churches subjected to the disgorgement of debtors' tithes from their already tight funds. Both the Magic Valley Evangelical Free Church and Broadway Avenue Baptist Church in Idaho have been forced to surrender tithe monies that they have spent long before the trustee decides to pursue those funds. Often, these churches operate on a week-to-week basis, and are unable to set aside large sums in the event that one of their parishioners may declare bankruptcy.

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What is happening to our churches represents a serious threat to those who follow the dictates of their conscience and the framework of their religious beliefs. Many give a portion of their income as tithes to their religious institution; some based on faith, others based on scripture, others based on religious obligation. I think you will agree that our nation's foundations clearly were not based on the notion of depriving her citizens of their religious freedom in this way.

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There are two primary concerns which must be key components of legislation to address this problem.

First, it must be stressed that the concept of protecting tithes to churches and religious institutions has firm Constitutional standing. As we will hear from later expert Constitutional witnesses, there is no need to connect churches to 501(c)(3) groups in order to pass Constitutional muster.

Any attempt to combine churches with non-profit 501(c)(3) groups, no matter how well-intentioned, could result in the subjection of churches to further governmental regulation down the road. To date, no non-profit group has been subject to the same treatment as churches under the bankruptcy code, so their inclusion solves a non-existent problem. Making this connection only serves to start us down the slippery slope of government regulation of our churches.

I recognize that the motive is to pass Constitutional muster, however, this inclusion is not necessary. The Supreme Court has, on numerous occasions, rejected the argument that exemptions for religious activities are unconstitutional if not extended to secular activities.

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Indeed, the Supreme Court stated in *Corporation of Presiding Bishop* v. *Amos* (1987), that ". . . the government may (and sometimes must) accommodate religious practices and that it may do so without violating the Establishment Clause." The protection of Constitutional rights serves a social, secular purpose, not a religious one. I don't profess to be an expert in Constitutional Law, but the Subcommittee will hear from experts who agree.

The second area of major importance is the definition of tithes. The government should not be in the business of attempting to do what only scripture should do. Assigning any numeric value or cap to tithes puts the autonomy of religion in danger. I believe we should be very leery of any language that would attempt to attach a figure to a tithe. As members of Congress, we have the authority to rewrite laws, but we cannot and should not attempt to rewrite scripture. Scripture defines tithes, not the federal government.

In determining the legitimacy of fund transfers, the tests of giving patterns and history should continue to be applied so as to protect the giver's free exercise rights. This should be balanced by language allowing the trustee the discretion to determine intent to defraud. My bill makes room for both of these components.

Finally, I would add that it is crucial in determining action on any legislation that we ask ourselves, "What is the right thing to do?"; not "What is the most politically expedient thing to do?"

A solution that would include non-profit groups may sound both politically and rhetorically attractive. However, I believe there is a very clear problem facing our nation's churches and churchgoers, and there is a very clear answer to dealing with it. My Religious Fairness in Bankruptcy Act provides a lucid solution to this unjust intrusion into religious free exercise. 501(c)(3) organizations are a creation of the state; churches are not. H.R. 2611 is the best approach to specifically address the invasion of religious freedom in our nation's churches, and it is the right thing to do.

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It is important that the doctrine of the separation of church and state be kept in tact. Any challenges to this legislation under the Establishment Clause will be unsuccessful. The type of exemption included in H.R. 2611 is wholly Constitutional, as you will hear from other witnesses today, and it does not present Establishment Clause conflicts. The components of H.R. 2611 are consistent with the Supreme Court's rulings in recent cases dealing with

religious freedom.

Formulating a solution to a problem that does not exist would only exacerbate the already rising problems of bankruptcy and debt that our nation has been faced with in the last decade. Let's stick to the task at hand, and address separate issues with separate legislation.

Again, I would like to thank Chairman Gekas, Ranking Member Nadler, and the members of the committee for the opportunity to address this body and for the work of both yourself and the staff in preparing this hearing.

I would also like to thank Mr. Grassley and Mr. Packard for their hard work to defend the rights of Americans to practice their religious beliefs.

Thank you, Mr. Chairman, and I look forward to working with you in ensuring the passage of an effective piece of legislation that will provide a solution to this growing problem.

[The bill H.R. 2611 follows:]

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INSERT OFFSET RING FOLIOS 1 TO 2 **HERE**

Mr. **GEKAS.** We thank the lady for her presence here and for her testimony.

The chair notes the attendance and presence of the gentleman from Tennessee, Mr. Bryant, and we are now ready to shift to the gentleman from California, with whom I first came into the Congress in 1983. Knowing him has been like pulling teeth, like he was prone to do before he came to the Congress. Representative Packard.

STATEMENT OF HON. RON PACKARD, A REPRESENTATIVE IN CONGRESS FROM THE STATE OF CALIFORNIA

Mr. **PACKARD.** Thank you very much, Mr. Chairman. It is a pleasure to be before your subcommittee, and members of the subcommittee, I appreciate your being here.

I am going to ask unanimous consent that my statement be entered into your record and hopefully, you and your staff will read it. It is a beautiful statement and you will love to read it, but I would simply like to summarize and kind of talk about it.

Mr. **GEKAS.** Without objection, the statement written by the gentleman and submitted will be admitted to the record.

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[The prepared statement of Mr. Packard follows:]

PREPARED STATEMENT OF HON. RON PACKARD, A REPRESENTATIVE IN CONGRESS FROM THE STATE OF CALIFORNIA

Let me begin by thanking you, Chairman Gekas, and you Mr. Nadler, for holding this hearing on what I consider to be an important matter.

Later in this hearing you will hear from the bankruptcy law experts. What I would like to discuss here, is my involvement in this process. When I first learned of the problem that churches and charities were having, that creditors were allowed to sue for donations made by donors prior to their filing bankruptcy, I thought it was a travesty.

Many, many of our churches and charities across this country live hand to mouth. What comes into the collection plate on one day is usually spent the next. When a creditor is allowed to sue a church or charity in order to recover a donation made possibly months earlier, the church or charity is usually put in a position of hardship. What is more, they rarely have the ability or resources to fight the suit in court, which in some cases can lead to financial ruin.

I do not believe that a church or charity that receives a tithe or donation, ought to have to check the financial background of the donor. They certainly should not be penalized for receiving a donation from anybody, but that is exactly what is currently happening. My bill and Senator Grassley's bill would correct that.

In addition to protecting churches and charities, our bill also assists the individual donor himself. Currently, a person who files for bankruptcy under Chapter 13, is not allowed to make charitable contributions or tithe to a church. Amazingly, the courts have said that in making this type of contribution, the donor receives nothing of value—nothing. I do not accept this.

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Under Chapter 13, a person can go to a bar and buy a beer. They can go to the movies. They can buy a television. But, they cannot throw a dollar into the Sunday collection plate. I am sure you all realize how demoralizing and embarrassing this could be for someone sitting in church every week. Not to mention how this might adversely affect their faith. Our bill would set reasonable standards to allow individuals to make these contributions.

Mr. Chairman, I don't think any of us would disagree that what is happening to our churches and charities is wrong and should be stopped. I have spoken of this problem with just about everyone on either side of the aisle and all agree that we should not allow this sort of thing to happen in America.

It has been our intention all along to draft legislation that Congress can quickly approve with full bipartisan support. It has also been our intention, to produce a solution that will withstand a constitutional challenge in any court. We all feel strongly about this issue and each of us has the best of intentions, but a passionate defense of religious freedom is not going to be enough to stop this problem. Moreover, by linking churches with 501(c)(3) organizations, we have crafted a bill which will solve a problem within the framework the courts have already defined.

As most of you know, I come from a citizen lawmaker background. I want to pass legislation which corrects problems, not legislation which creates problems. And, I want to do so bipartisanly.

Our churches and charities desperately want and need Congress to correct this problem with legislation that can withstand a challenge from any court. I strongly believe, and I suspect many testifying here today will agree, that Senator Grassley and I have produced a bill that will both fix the problem and withstand a constitutional challenge.

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Mr. Chairman, I am not an attorney and I am not an expert on bankruptcy law. However, I have worked with charities for a number of years and I have been active enough in my church to know how devastating this can be if Congress does not act quickly to correct this. It is my hope that we can pass this legislation out of committee unanimously and get it to the floor of the House as soon as possible.

Chairman Gekas, Mr. Nadler, members of this subcommittee, I want to thank you for holding this hearing today. I look forward to answering any questions you might have.

Mr. **PACKARD.** Thank you. I first became aware of this problem really through the newspapers. I read an article that indicated that a church in Minnesota had filed suit and fought this in court and lost this in court, and then appealed and won the appeal in the Eighth Circuit Court of Appeals, and then ultimately lost it before the Supreme Court. When I read the article and then saw that Senator Grassley was holding hearings on this issue and ultimately was going to

introduce legislation, I consulted with Senator Grassley. We determined that we would develop and introduce the identical language, and his language on the Senate side is identical to mine here on the House side.

That is how I became aware of the problem and ultimately dropped my piece of legislation into the hopper. I felt that was unconscionable, unbelievable in fact that a church would be held responsible to return contributions when one of their members went bankrupt, contributions that were made by the member of their church that went bankrupt. I felt, how could a church be responsible or connected in any way to the bankruptcy of the individual member and thus be required to return the funds.

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Churches live on a day-to-day basis almost by the contributions that come in. It is almost impossible for them to plan for or budget for the return of sizable contributions, so this really presents a terrible hardship on churches, particularly.

We also felt, and in my instance, I recognize that we are not consistent with Mrs. Chenoweth's bill, but we have included charitable 501(c)(3) organizations. I believe that they ought to be protected as well. They are not in the same category as churches, but they certainly are vulnerable to the same problems, and even though Mrs. Chenoweth brings up the point that no nonprofit organization has been challenged like the churches have been, now that the court has finally rule in this past year and made a final determination, I think the Boy Scouts, the Red Cross, and charitable organizations will be wide open for attacks by courts and by attorneys in an effort to recoup for their creditors. I believe that they will become vulnerable as churches are now vulnerable. On the merits themselves, I believe that charitable organizations ought to be included.

I would like to protect the Boy Scouts, the Red Cross, and all of the other charitable organizations that are doing wonderful things to take care of people's needs in this country. They deserve that kind of protection. It would be a tragedy for them, especially a soup kitchen, to have to find several thousand dollars that was contributed to them simply because someone went bankrupt.

I belong and I was one of the original members of a group in the House and Senate called the Renewal Alliance, and our objective is to go out and meet with charitable organizations, encourage them, and strengthen them, and try to help find money and contributors for them. I would be sick if we found contributors or they found contributors that would help them stay open as a soup kitchen or as an agency that takes care of homeless and hunger and so forth, which I have attended many of them here in the east and several in my district over the last few months. They do wonderful things. I would hate for them to have to return monies that we encouraged and helped them find because someone might have gone bankrupt that was totally unrelated to the church or to the charitable organization.

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I believe that on the merits themselves we ought to include them, but I think it is extremely important that we move this kind of legislation to solve a problem. That is all I want to do is solve a problem that is out there, and I became aware of the problem, and we drafted legislation to solve that problem.

I would hate to see us be successful in moving this kind of legislation that would then get bogged down in the courts and be thrown out like RFRA was on a constitutional nature. That would certainly delay the solving of the problem.

I personally, Mr. Chairman, would like to see this move as an independent piece of legislation rather than be wrapped into the bankruptcy reform bill. That is going to be much more complicated, and this is a very simple rifle shot at a problem, and we would like to see this move quickly, both in the House and Senate. I believe it will, and it would be my preference to keep it separate from the bankruptcy reform bill.

We have tried desperately to craft language that would protect and avoid and prevent fraud. No one, certainly this member, does not wish to lay any groundwork that would allow someone to fraudulently use the church or a charitable

organization to make a contribution to avoid their creditors if they are going into bankruptcy. I would be the very last to wish for that. We have tried to put language in this bill that would protect against that kind of fraudulent effort.

I would be very amenable to any language that the subcommittee and the full committee would like to see in an effort to protect against that problem. We would not wish to see our bill used to protect fraudulent efforts to avoid creditors.

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We really feel that churches are not responsible, and there is no way that they can determine whether their members are near bankruptcy or going bankrupt. I think it would be inappropriate for the church to investigate.

For me personally, and I speak from a personal point of view, I belong to a church where tithing is a commandment. It is as much a commandment as all the other commandments, and my obedience to that commandment which I have lived all of my life since childhood; there has never been a year in my entire life that I have not been a full tithe-payer to my church, and I consider that I am not practicing my religion if I am not permitted to pay tithing. If I go bankrupt, I still ought to be permitted to pay tithing and be obedient to the church commandments that I have accepted.

For my contributions, if for some reason I went bankrupt that the couple that initiated this problem in Minnesota who had been paying tithing historically to their church for years and then the recession came in 1990, and a heart attack came to the breadwinner and it forced them into bankruptcy. It was not of their doing and certainly not of the church's doing, and that is when the attorneys went after the $13,500 that they had contributed over the previous 3 years to their church.

I would not want that to happen to my church or to me personally if I unfortunately went into a bankrupt situation. I believe that we have targeted this problem. We have sought an answer to it, and we think that this is a good answer.

After I dropped the bill in the hopper, I quickly spent the next two days meeting with members on both sides of the aisle on the issue, and within two days, I had 121 co-sponsors, almost as many from the Democratic side as the Republican side. I have not found one member of Congress that I have explained what we are trying to do that hasn't been agreeable to what we are trying to accomplish.

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I hope that this subcommittee will act favorably upon this bill, and as I mentioned, I have co-sponsored Mrs. Chenoweth's bill and support it. I just believe that we ought to avoid any constitutional challenge, and I think mine and Senator Grassley's would do that.

I would hope that the subcommittee would move quickly on it and would allow it to come to the floor quickly. I think that we can almost be assured of a very positive vote, and the Senate appears to be doing the same from what we have heard this morning in the testimony of Senator Grassley.

I sincerely appreciate your listening, your time, and consideration of these bills. Thank you very much, Mr. Chairman.

[H.R. 2604 follows:]

INSERT OFFSET RING FOLIOS 3 TO 8 **HERE**

Mr. **GEKAS.** Thank you very much, Representative Packard, and I will not foreclose, I will say to my colleagues, the possibility that the bill will launch itself as an independent piece of legislation. I merely restate that the possibility exists that it would be folded into a total bankruptcy reform bill.

With that and with gratitude, we excuse our colleagues.

Mr. **PACKARD.** I will answer any questions if there are any.

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Mr. **GEKAS.** If you want to subject yourself to questions and if Mr. Bryant has any questions——

Mr. **BRYANT.** No questions.

Mr. **GEKAS.** You are excused. Thank you very much. The lady from Texas has submitted a written statement, and without objection, it will be entered into the record.

[The prepared statement of Ms. Jackson Lee follows:]

PREPARED STATEMENT OF HON. SHEILA JACKSON LEE, A REPRESENTATIVE IN CONGRESS FROM THE STATE OF TEXAS

Good morning, ladies and gentlemen. First of all, I want to thank the Chairman for holding these hearings on a subject that I think, in some part, affects all of us. The important question that rests before this Subcommittee today is not simply whether our bankruptcy laws, as they stand, are effectively negating the protections for religious freedom afforded by the 1st Amendment of our Constitution, but whether this Congress will continue to be a strong defender of civil and Constitutional rights. Although we often do so, the Constitution and the rights it extends to the citizens of this country is something that we must not take for granted. According to Judge Alphonzo Taft, father of President and Chief Justice William Howard Taft, "The ideal of our people as to religious freedom is absolute equality under the law of all religious opinions and sects . . . the government is neutral and while protecting all, it prefers none and disparages none."

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The right to express one's religious beliefs freely, as long as their expression does not harm others, is a fundamental part of the American experience. Those who came to this country to found the early American colonies nearly four centuries ago, did so in order to escape the bitter sting of religious persecution. So it is no surprise that the first Amendment to the Constitution crafted by the descendants of these brave trailblazers was an attempt to ensure free religious expression. Although at times it is difficult to see, as Americans, we are the products of a great legacy of freedom. A legacy that we, as Members of the United States Congress, have been duly empowered to continue on the people's behalf.

However, in large part, the lasting impact of this Subcommittee, and of this 105th Congress, on the people that we have been elected to serve, still remains to be determined. One thing is for sure, whether we are Democrat or Republican, liberal or conservative, male or female, Black or White, is the fact that the Members of this Congress have a sacred duty to be vigilant defenders of the public good. I believe that a vote of confidence, at least, for the civil libertarian spirit of H.R. 2604, the Religious Liberty and Charitable Donation Protection Act, and H.R. 2611, the Religious Fairness in Bankruptcy Act of 1997, is appropriate. Even if the members of this Subcommittee must disagree on the means employed by these bills to bring religious justice to our bankruptcy laws, we can all still appreciate their desired result. As proponents of freedom, these bills cut to the heart of what our Constitution and country are really all about.

However, at another level, these bills remind us of the challenge before us to be at the forefront of the many sorely-needed reforms to our consumer and commercial bankruptcy laws. H.R. 2604, of which I am a co-sponsor, seeks to protect any religious and charitable contribution of a debtor made within one year of their filing for bankruptcy from possible recovery by a Trustee or creditor. Essentially, a Chapter 13 participant can be barred from tithing to their local

church if their creditors object to the addition of this gift to their debt restructuring plan. Additionally, in Chapter 7 cases, religious contributions can be used as suitable basis to dismiss a debtor's case on the grounds that they are substantially abusing the Chapter's many favorable bankruptcy provisions. At some point, this subtle form of religious persecution must stop.

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Recently, the position of many of our federal courts has been that there is no suitable exchange of services in a contribution to a religious institution for the debtor, as mandated by the rules of the Bankruptcy Code. In response, H.R. 2611 seeks to establish in the Code that any donation made to a religious organization should be viewed as an exchange made for a reasonably equivalent value. Hopefully, this bill, after further review and scrutiny, will prove to be an effective way of protecting the religious freedoms of our debtors. But at this point, it does seem that non-religious charitable contributions that are also motivated by religious reasons should be included in this exception. Potentially, the one-sided exception proposed by this bill could have serious Constitutional implications. Nevertheless, the improvement of our bankruptcy laws in this area is necessary. How can we expect debtors to enter a bankruptcy system that, at present, does not adequately recognize their Constitutionally protected civil liberties?

Especially at this time when several other sections of Title 11 of our Federal Code are under serious legislative review by this Congress, efforts to provide protection for the charitable and religious donations of debtors are particularly important. If any of the current legislative initiatives that encourage debtors to enter into Chapter 13 recommitment plans are passed, without first enacting these necessary protections for religious contributions of debtors, then this growing deficiency in our bankruptcy laws will surely be exacerbated.

Ultimately, the purpose of this hearing is to determine whether the bills before us are the best way to serve the common good. If these bills are proven to be a just and fair way of maximizing the religious freedom of our debtors, they will surely receive my full support. If not, I hope we all can work together to find a more effective solution. I want to welcome the body of experts composed of our colleagues, many concerned religious leaders and noted advocates of religious freedom who will be testifying before us today. And I hope that their insight will bring us much closer to achieving our common objectives for freedom and justice in the very near future. Thank you.

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Mr. **GEKAS.** The next panel is made up of Professor Douglas Laycock of the University of Texas, one of the very few scholars in the country to have studied both religious liberty and bankruptcy. He has taught and written about religious liberty for 20 years, and has taught secured credit including the avoiding powers of the trustees in bankruptcy for 10 years. He is counsel for churches in two of the pending test cases on whether contributions to churches are fraudulent transfers.

Secondly, we have Mike Farris, a constitutional attorney, author, and speaker. He is the founder and president of the Home School Legal Defense Association which has some 54,000 member families and was a leader in the development of the Religious Freedom Restoration Act which was signed into law by President Clinton in 1993. He is a graduate of Western Washington University and received his law degree in 1976 from Gonzaga University in Spokane, Washington.

Also present is Dr. Stephen Paul Goold, Senior Pastor of the Crystal Evangelical Free Church of Minneapolis, Minnesota, which has been involved in one of the major cases raising issues relevant to today's hearing. Dr. Goold received his Bachelor's degree in music education from Drake University; a Master of Divinity and Master of Theology degree from Talbot Theological Seminary, and a Doctor of Ministry from Trinity International University.

Joining him and the others at the witness table will be Steven McFarland, Esquire, Director of the Center for Law and Religious Freedom in Annandale, Virginia. Founded in 1975, the center is funded by the Christian Legal Society, and defends the religious liberty of people of all faiths. He coordinates a nationwide network of experts in church-state law and the preparation of legal research, briefs, and strategy involving freedom of religious belief and practice. Prior

to his current position, Mr. McFarland was a trial attorney in Seattle, Washington. He received his Bachelor of Arts degree from the University of California at Santa Barbara in 1977, and his juris doctor degree from UCLA in 1980.

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These individuals will be joined by Mr. Stephen H. Case, Esquire, who represents the National Bankruptcy Conference as an attorney with the firm of Davis, Polk, and Wardwell in New York City. Mr. Case was senior advisor to the National Bankruptcy Commission, and had served from 1992 to 1996 as vice chair on the committee on legislation of the National Bankruptcy Conference. He received his undergraduate and law degrees from Columbia University. Mr. Case's professional accomplishments would be too lengthy to chronicle in the short time we have available, but they certainly describe, we are sure, a distinguished career in the field of bankruptcy law.

Finally, Ralph Hardy, Jr., President of the Washington, D.C. Stake of the Church of Jesus Christ of the Latter-day Saints. He received his undergraduate degree from the University of Utah and law degree from the University of California at Berkeley. He joined the Washington, D.C., law firm of Dow, Lohnes, and Albertson in 1969 and has been a partner since 1974. He has served his church in a variety of roles, and in 1990, succeeded Mr. J. Willard Marriott, Jr., as the president of the Washington, D.C. Stake.

We have been joined by the gentleman from Massachusetts, Mr. Meehan, and we are now prepared to proceed. By special accommodation, we will ask Mr. Mike Farris to speak first and then allow him to be separately questioned and then excused as he has commitments which we will attempt to honor.

Mr. **BRYANT.** Mr. Chairman, may I ask unanimous consent?

Mr. **GEKAS.** Yes. The chair recognizes the gentleman from Tennessee.

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Mr. **BRYANT.** Thank you. I have to be at a hearing, an Ethics Committee hearing, and I must be there at 11:00, and I need to excuse myself. I want to hear the testimony of these witnesses. I certainly have their statements, but I wish they could address, if they feel it appropriate, just a couple quick questions during their discussion.

Mr. **GEKAS.** The gentleman may proceed.

Mr. **BRYANT.** I will try to get back by noon, but I don't know if we will still be in session at that point.

I favor this type of legislation, but I have a couple of concerns. I would tend to support a bill that would limit it to churches, to religious organizations as defined by the tax code as opposed to all other types of charitable organizations.

I would also tend to support ten percent of income per year versus—I am not sure where 15 percent comes from, but my understanding of a tithe is ten percent, and that this avoidance power of trustees be limited to one year as opposed to being able to go through state laws under section 544 and reach back even further.

It seems to me the issue here is not the hardship caused on charitable organizations in general having to give money back, but one of a religious right, and therefore, I would be in that situation of limiting it to religious organizations.

With those kinds of comments, I appreciate the indulgence, and I will use my best efforts to get back here as soon as this hearing is over.

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Mr. **GEKAS.** We thank the gentleman, and we will look forward to his reappearance.

Mr. Farris.

STATEMENT OF MICHAEL P. FARRIS, ESQ., PRESIDENT, HOME SCHOOL LEGAL DEFENSE ASSOCIATION

Mr. **FARRIS.** Mr. Chairman, thank you so much for the opportunity to testify and especially for the special privilege you have accorded me to adjust my schedule.

I have submitted my written testimony and I won't read it to you now, but just ask that it would be considered and distributed and published in the record if the chairman is willing.

Mr. **GEKAS.** Without objection, the statements of all the witness will be accepted for the record, and we will request that each witness restrict their oral comments to about 5 minutes.

Mr. **FARRIS.** Thank you, Mr. Chairman. I will probably be faster than that.

I was the chairman of the drafting committee that wrote the Religious Freedom Restoration Act, and I obviously was quite disappointed when the Supreme Court ruled the wrong way on that and said that our constitutional rights are both a floor and a ceiling of our rights, that our elected officials can confer on us no greater rights than the Constitution guarantees as a minimum. I think it is a preposterous theory of constitutional law, but that is what we are stuck with for the time being.

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Mr. Laycock argued that case in the Supreme Court and he will, of course, be better equipped to tell you. I was there observing, and there was a great deal of discussion of the difference between wholesale exemptions, religions exemptions which was the case in RFRA, and retail exemptions, which are narrow exemptions designed for specific purposes.

There is no question whatsoever that has ever been raised as to the constitutionality of retial of a single religious exemption drawn for a particular purpose.

The problem the court had with RFRA was that RFRA was, in the court's view, trying to interpret the Constitution. Mrs. Chenoweth's bill, H.R. 2611, is not trying to interpret the Constitution but is telling the courts how to interpret the Bankruptcy Code, and there is no question that has ever been drawn about Congress' power to tell the courts how to interpret the Bankruptcy Code, even on the subject of religion.

The idea that some have that if we give religion a singular treatment in our codes, a constitutional violation of the Establishment Clause is just laughable. I don't believe that in this kind of context that principle has any application whatsoever.

I won a fairly recent Establishment Clause decision before the United States Supreme Court, nine to zero, in which a blind ministerial student was singled out and said you can't participate in a program of vocational rehabilitation financed by the government because you have this religious motive. The Supreme Court of Washington ruled five to four that indeed, the federal Establishment Clause banned that.

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Justice Thurgood Marshall wrote the unanimous opinion of the Supreme Court reversing that decision in the Witters case and said to allow a religious person to participate in an otherwise available program is not in any way a violation of the Establishment Clause.

I am not an expert on bankruptcy law, but what I understand is this. If you go out and gamble and spend ten percent

of your income at Las Vegas the weekend before you declare bankruptcy, you can't touch it. It is only religion that is singled out for this kind of unprecedented recovery action because they say there is no value to religion.

By adopting this bill, you would be simply evening the score, allowing religious transactions to be treated in Bankruptcy Code as having some value to them. I think personally there is a lot more value to giving money to your church than going to Las Vegas. We would simply even the score, and to say that there is a religious preference here that is unconstitutional in some way is just absolutely to me preposterous.

I don't have a policy problem with including other organizations per se, but you don't need to do it. You can limit this to simply the religious organizations which are the only ones that are having the problem, and I don't think there is anybody who—at least I don't believe there is any legitimate basis for claiming that there an Establishment Clause problem from doing this.

One other quick example. The Amish were allowed to opt their children out of high school in *Wisconsin* v. *Yoder,* and the Supreme Court found no basis whatsoever for saying that was an Establishment Clause problem to let the Amish be exempt from attendance at high school, and the Court said very clearly that people who have a philosophical reason only for these kinds of special treatments don't get it. You have to have a religiously motivated basis for your conduct to receive the blessing of the Free Exercise Clause that was exercised in *Wisconsin* v. *Yoder.* The idea that religion cannot be given different treatment just ignores the whole idea of the Free Exercise Clause.

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I think it is clearly constitutional, and I don't believe that there is any legal reason to choose the (c)(3) method. That is simply a policy question that this Congress needs to make.

[The prepared statement of Mr. Farris follows:]

PREPARED STATEMENT OF MICHAEL P. FARRIS, ESQ., PRESIDENT, HOME SCHOOL LEGAL DEFENSE ASSOCIATION

Mr. Chairman and members of the Committee, it is an honor to be invited to testify before this committee on behalf of the 55,000 families that are members of the Home School Legal Defense Association. A majority of our members are evangelical Christians, but we represent families from virtually every religious group in America—Jewish, Christian, eastern religions and others. We are committed to defending religious freedom for everyone. That commitment has brought me here today to support the Religious Fairness in Bankruptcy Act, H.R. 2611.

The bulk of my twenty-two years of legal practice has been as a free exercise litigator for legal foundations, most notably Concerned Women for America's Education and Legal Defense Foundation, in private practice, and at HSLDA. This experience led me to actively participate in the Coalition for the Free Exercise of Religion, which drafted the Religious Freedom Restoration Act of 1993, or RFRA.

I had the honor to be the co-chairman of the drafting committee for the RFRA. It was an unusual, yet gratifying experience to work side-by-side with attorneys from organizations I have often faced as opponents in the courtroom. While we disagree on the outcome of many, many cases, we shared an unwavering commitment to the principle that the free exercise of religion should be treated as a fundamental freedom. This is one of those bedrock principles that virtually all Americans share regardless of our political or religious affiliation. That is certainly true of our elected officials: the House of Representatives voted unanimously for the RFRA in 1993; the Senate voted for 97 to 3 in its favor; and President Clinton signed it with great enthusiasm.

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The RFRA was drafted to make sure that every American continued to enjoy the religious liberties that we have long associated with the First Amendment. Up until 1990, there was a wide-spread consensus that the Constitution shielded

individual citizens from government practices and policies which burden the free exercise of religion. That sense of security was rudely shattered in 1990, when the United States Supreme Court ruled, in *Employment Division, Department of Human Resources of Oregon* v. *Smith,* 494 U.S. 872 (1990), that the First Amendment protected a far narrower category of religious practices.

Religious people were shocked by this ruling, and law professors were appalled. Civil liberties lawyers like myself rapidly discovered that religious believers—especially those of minority faiths—were losing their ability to obey the dictates of their consciences. Congress sought to respond to this situation by enacting remedial legislation.

Section 5 of the Fourteenth Amendment expressly gives Congress power to enforce, by appropriate legislation, the guarantees of due process and equal protection for all Americans. Our drafting committee relied on this section of the Constitution to restore religious freedom in America. We also relied on an earlier Supreme Court case which upheld a similar Act of Congress. Back in the late 1950s, civil rights activists had challenged the literacy tests which many states used to keep African-Americans from the polls. The Supreme Court ruled, in *Lassiter* v. *Northampton Election Bd.,* 360 U.S. 45 (1959), that literacy tests were not unconstitutional. Congress dared to disagree with this ruling, and enacted the Voting Rights Act of 1965, which forbade such literacy tests. This law was promptly challenged, but the same Supreme Court which had said that these literacy tests were not unconstitutional had no objection to an Act of Congress which made them illegal. *Katzenbach* v. *Morgan,* 384 U.S. 641 (1966). We sought to protect religious liberties in exactly this way by enacting the RFRA.

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If the RFRA were still on the books, we would not be here today. In the spring of 1997, religious people and civil libertarians across America were once again shocked, this time by the Supreme Court's ruling in *Boerne* v. *Flores,* **XXX** U.S.**XXX**, 138 L.Ed.d.2d 624, 117 S.Ct. 2157 (1997). The Court distinguished the RFRA from the Voting Rights Act, upholding the sweeping laws which protect voting rights, but striking down the sweeping laws which protect religious liberties. The results have been swift and sad: religious liberties are being eroded across America. Who would have thought that here, in America, a church would be sued and forced to refund tithe money that had been donated in good faith by a church member in good standing? Yet it has happened, as the pastor of that church can tell you here today.

The loss of these liberties are not theoretical. Real people are suffering real consequences. Religious believers like myself are free to give or not give to charity as we choose, but, for those who share my particular beliefs, if we refuse to give to the church where we attend, we violate very specific Scriptures. The prophet Malachi wrote, in the last book of the Old Testament, "Will a man rob God? Yet you have robbed me. But you say, wherein have we robbed thee? In tithes and offerings. You are cursed with a curse: for you have robbed me, even this whole nation." Malachi 4:8–9. As a constitutional lawyer, I grieve at the thought that sincere religious believers would be forced to choose between "robbing God" and violating the bankruptcy laws.

Representative Chenowith has drafted a simple bill which would solve this specific problem. It is called the *Religious Fairness in Bankruptcy Act of 1997.* The logic of this bill is simple, and coherent. It starts with the premise that religion has real value to a religious believer. Bankruptcy courts should therefore treat religious values with the same respect they would treat any other value.

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The logic of this bill was specifically addressed in *Smith,* which analyzed the Court's earlier religious liberty cases, including *Sherbert* v. *Verner,* 374 U.S. 398 (1963); *Thomas* v. *Review Board,* 450 U.S.707(1981); and *Hobble* v. *Unemployment Appeals Comm'n of Florida,* 480 U.S. 136 (1987). The Court explained that each of these cases could be explained by the proposition that, "[W]here the State has in place a system of individual exemptions, it may not refuse to extend that system to cases of 'religious hardship' without compelling reason." *Smith,* 494 U.S. at 884. Rep. Chenowith's bill simply places exemptions for religious value received into a system of individual exemptions in the bankruptcy code for other kinds of value received, and is therefore completely consistent with the *Smith* court's

interpretation of those earlier religious liberty cases.

I was shocked to hear that some people now claim that this bill might be struck down by the Supreme Court. I am dismayed to find that people so completely misunderstand religious liberty law, and appalled to see how quickly the ruling in *Boerne* has "chilled" legislative efforts to protect religious liberties. This "chilling" is particularly tragic because it is so completely at odds with the actual language and logic of the *Smith* case.

When the Supreme Court struck down our traditional understanding of the First Amendment in *Smith* in 1990, they did *not* rule that Congress could not draft specific legislation protecting religious liberties. Quite the contrary: they insisted that the guarantees of the First Amendment were to be fulfilled by having legislatures craft specific religious exemptions from otherwise neutral, generally applicable law. The *Religious Fairness in Bankruptcy Act* is exactly the kind of specific religious exemption that the Court invited.

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When the Court heard oral arguments in the *Boerne* case in 1997, there was a great deal of discussion about the difference between specific legislative exemptions (which the Justices called "retail" exemptions) and broad rules of decision in all cases (which were referred to as "wholesale" exemptions). RFRA was struck down because the Court held it was a Congressional interpretation of the Constitution. The Supreme Court ruled, in *Boerne*, that only the Court may interpret the Constitution. The *Religious Fairness in Bankruptcy Act*, which is before this committee, would not be struck down because it interprets the bankruptcy laws, not the Constitution.

The *Smith* court invited Legislatures to craft these "retail" exemptions for religious believers. In *Smith*, as you may know, the Court ruled against a member of the Native American Church who claimed that his sacramental use peyote should not be treated as "work-related misconduct" under Oregon's unemployment compensation law. Five Justices refused to find a "wholesale" exemption for religiously motivated actions, but they noted that three States had made an exception to their drug laws for sacramental peyote use. *Smith*, 494 U.S. at 890. (The dissenters in the case noted that the Code of Federal Regulations and 23 States had statutory or judicially crafted exemptions in their drug laws for religious use of peyote. Smith, 494 U.S. at 912, n.5.) The *Religious Freedom in Bankruptcy Act* is just such a "retail" exemption which will clearly and specifically protects the free exercise of religion.

When the *Smith Court* rejected "wholesale" exemptions for religious practices, they urged society to "be solicitous of [religious belief in its legislation." *Smith*, 494 U.S. at 890. That is exactly what Rep. Chenowith has done here. To argue that the Supreme Court will repudiate its own language in *Smith*, turn around, and strike down the legislation before us is to suggest that the Court is both hypocritical and fundamentally hostile to religion itself. To suggest that this bill, as drafted, is actually unconstitutional is to imply that the Free Exercise Clause of our Constitution no longer exists.

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There may be those legislators who do not want religious beliefs to be accommodated in our bankruptcy courts. Under our current Supreme Court rulings, such legislators are free to vote *against* the free exercise of religion and what I believe to be the most sacred guarantee of the Bill of Rights. But let no one here hide their secret hostility to religion behind the thin excuse that the Supreme Court will not permit it. It is not true.

I therefore urge this committee, and this House, to vote unanimously *for* the *Religious Freedom in Bankruptcy Act*. If you do not protect religious liberty, who will?

Mr. **GEKAS.** Does the gentleman from Massachusetts wish to pose any questions to Mr. Farris?

Mr. **MEEHAN.** Not at this time, Mr. Chairman.

Mr. **GEKAS.** We thank the gentleman, and as we indicated, his statement will be included in the record, and we

excuse him with our gratitude.

We will now turn to Mr. Laycock.

STATEMENT OF DOUGLAS LAYCOCK, PROFESSOR, UNIVERSITY OF TEXAS LAW SCHOOL

Mr. **LAYCOCK.** Thank you, Mr. Chairman. The fraudulent transfer laws have been part of Anglo-American law for 400 years, as another witness says in his statement. In all of that time, these claims against churches did not exist. They were not filed. No one thought the fraudulent transfer laws meant that churches had to give back contributions.

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The first such claim to be successful was in 1992 against the Crystal Free Evangelical Church. That case is still on appeal.

This is a new misinterpretation of the law. It is not what Congress intended, but it is quickly becoming the dominant interpretation in the courts. If it becomes the settled law, then it will be simply a routine checklist item to ask every bankrupt about contributions to his church.

In 97 percent of consumer cases today, there are no assets to distribute to creditors. Only three percent have assets, but many more than three percent give to their churches. What this emerging body of law means is that churches will become the primary source of funds for distribution to the consumer credit industry in American bankruptcy courts, and suits by trustees against churches will become the most common form of adversary proceeding in American bankruptcy courts. I am quite confident that is not what Congress intended when it passed §548(a)(2).

H.R. 2604 does a very good job of fixing this problem. It is a complicated problem. There are three potential sources of liability, section 548, section 544, and state law.

Mr. Packard's bill fixes two of them, §544 and 548. The other bill addresses only §548 so it would not change the result in a single case. It would simply move all this litigation to §544, and it would do no good whatever.

Neither bill closes off the third route, which is that these claims can be filed under state law. They never used to be filed under state law, but now that there is this emerging body of federal bankruptcy law, imitation suits are beginning to be filed in state court.

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I am involved in one of those cases. The Cedar Bayou Baptist Church in Baytown, Texas is the victim of a $45,000 judgment in state court growing out of contributions that were made from 1988 to 1992.

For this bill to accomplish its intended purpose, it is necessary to preempt those state law claims at least once a bankruptcy has been filed. In my written statement at the bottom of page 13, I have proposed a sentence to be added to section 3 that would solve that part of the problem.

Let me briefly address this question that the gentleman from Tennessee asked about excluding secular charities.

First of all, there is a serious boundary problem: what is a religious organization? Religious schools, for example, would have to litigate whether they were religious or educational.

Second, the Establishment Clause problem is serious. I agree with Mike Farris that there is no Establishment Clause requirement that we include the secular charities, but we will litigate that issue until kingdom come if we don't include the secular charities.

The district judge in Idaho in the *Magic Valley* case just asked for supplemental briefing on the Establishment Clause. The bankruptcy judge in Massachusetts in the *Saunders* case declared RFRA unconstitutional in a bankruptcy context under the Establishment Clause. The issue is being litigated in the Eighth Circuit Case and it is being taken quite seriously there.

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At the very best, we will have 10 years of litigation waiting for the Supreme Court to tell us whether you have violated the Establishment Clause when you left out the secular charities, and I think that would be a significant mistake.

There is also this question about whether we are opening up the door for fraud. Can you drop off a check to your favorite charity on your way to the bankruptcy courthouse? I would like to say two things about that.

One, that temptation in this context is no different from, and in fact is less than the temptation that already exists in all sorts of other contexts. If I am a bankrupt debtor who understands the bankruptcy laws, why would I drop off money at a charity on the way to the courthouse? I could drop it off in my retirement plan and then I get to keep it. I could drop it off at my mortgage lender and pay it down on my house, which is exempt, and I would get to keep it. I could spend it on a fancy vacation or I could gamble it away in Las Vegas and have some fun out of it. Why give it to a charity if my motivation is to defraud my creditors? The temptation that is being created here is less than the temptation that already exists in all other sorts of contexts.

Second, both of these bills include the very important safeguard that they don't touch §548(a)(1). If I have been going along for years putting $5 a week in the collection plate and all of a sudden, before I file for bankruptcy, I clean out my last account and give 15 percent of my last year's income to my church, the trustee and the bankruptcy judge will look at the timing, the amount, the circumstances, the change in pattern, and they will say those are all badges of fraud. They will say I had the actual intent to hinder or defraud my creditors, and that is recoverable under §548(a)(1). The fraud scenario is not going to happen.

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What is going to happen is that the routine demand that churches refund contributions made many years before will come to an end, and churches will not become the most common defendants in federal bankruptcy court, which is the course we are headed on now.

Thank you, Mr. Chairman.

[The prepared statement of Mr. Laycock follows:]

PREPARED STATEMENT OF DOUGLAS LAYCOCK, PROFESSOR, UNIVERSITY OF TEXAS LAW SCHOOL

Thank you for the opportunity to testify this morning on proposed legislation to correct the emerging misinterpretation of the fraudulent transfer provisions of the Bankruptcy Code.

I have taught and written about the law of religious liberty for twenty years. For ten of those years, I also taught the law of secured credit, including the avoiding powers of the trustee in bankruptcy. I testify today in my personal capacity as a scholar. The University of Texas of course takes no position on any issue before the Committee.

I am also representing churches in two of the cases presenting the issue before the committee, including the only appellate decision so far. I represent the Crystal Evangelical Free Church in *In re Young*, 82 F.3d 1407 (8th Cir. 1996), *vacated*, 117 S.Ct. 2502 (1997), and I represent Cedar Bayou Baptist Church in *Gregory-Edwards, Inc.* v. *Cedar Bayou Baptist Church*, now pending in state court, in the Fourteenth Court of Appeal for Texas. Of course I am aware of my professional obligations to these clients, but I am not representing them today. The legislative issue for Congress

considering new law is different from the issue for the courts under current law. The views I will express on the legislative issue are my own, and I do not know whether they fully conform to the views of the two churches.

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I. The Problem and Its Source

The most serious problem facing Congress today is that courts have misinterpreted §548(a)(2) of the Bankruptcy Code, a prophylactic rule designed to simplify litigation over fraudulent transfers. The result is an avalanche of lawsuits against churches. If the present trend continues, lawsuits against churches are likely to become the most common adversary proceeding in federal bankruptcy courts, and churches will become the most source of funds for distribution in consumer bankruptcies. It is clear that Congress never intended this result.

At least since the time of Elizabeth I four hundred years ago, it has been unlawful to transfer property with the intent of hindering one's creditors. Courts early on developed the doctrine of "badges of fraud" to simplify the proof of fraudulent intent. One such badge of fraud was transfers without consideration while insolvent. When an insolvent debtor gives away his property for no apparent reason, the transaction is suspicious, and the law has presumed that it is fraudulent.

In 1918, the Commissioners on Uniform State Laws promulgated the Uniform Fraudulent Conveyance Act, adopted in twenty-five states, which dispensed with proof of intent altogether. Section 4 of that Act provided that if an insolvent person makes a transfer "without a fair consideration," the transfer is fraudulent "without regard to his actual intent." In the Bankruptcy Code of 1978, Congress adopted similar language to dispense with proof of intent, substituting the phrase "reasonably equivalent value" for "fair consideration." 11 U.S.C. §548(a)(2) (1994). The purpose of these provisions was to further simplify litigation of inherently suspicious transactions, by omitting the step of inferring fraudulent intent from the facts that made the transaction suspicious.

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We are now faced with an unintended consequence of that simplification. Trustees in bankruptcy, and even individual creditors, are successfully arguing that contributions to churches, made in the ordinary course of a long history of giving, are not in exchange for reasonably equivalent value and thus are irrebuttably presumed to be fraudulent. The result is that the church must pay the amount of the contribution to the debtor's creditors, usually long after the funds have been received and spent.

Congress did not intend this result. My research has not been exhaustive, but I am not aware of a single case in which a creditor or a trustee in bankruptcy challenged an ordinary course contribution to a church prior to the middle 1980s. Not under the Uniform Act, not under the badges-of-fraud doctrine, not under the Bankruptcy Act of 1898, and not under the new Bankruptcy Code for about the first eight years. The law that would support these claims has been in place for four hundred years; the key simplification that seems to drive these cases has been in place for eighty years. But no one imagined these claims until about ten years ago, and no such claim was successful until 1992. *In re Young*, 148 B.R. 886 (Bankr. D. Minn. 1992), *aff'd*, 152 B.R. 939 (D. Minn. 1993), *rev'd*, 82 F.3d 1407 (8th Cir. 1996), *vacated*, 117 S.Ct. 2502 (1997).

The length of time it took for someone to think of this theory shows that it was never intended. But now that someone has thought of it, the claim is becoming routine. If it is once clearly established that churches must pay such contributions to the contributor's creditors, it will become a routine item on bankruptcy forms to ask about contributions to churches, and it will become equally routine to demand that churches pay amounts equal to those contributions. There are currently no assets to distribute in about 96% of individual bankruptcies, so churches will become the primary source of funds for distribution to the creditors of bankrupt individuals.

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The same theory applies to all other charitable contributions, and secular charities may eventually be affected too. But in fact, nearly all the claims of this sort that I know about have been filed against churches.

II. The Error in the Emerging Judicial Interpretation

Charitable contributions in ordinary course are not inherently suspicious transactions, and they are no more fraudulent than any other consumer expenditure. They simply do not fall within the reason of the rule of §548(a)(2).

Section 548(a)(2) authorizes the trustee to recover certain transfers of property not in exchange for reasonably equivalent value. Except for contributions to churches, the courts have sensibly interpreted "value" to include any thing of value to the debtor. Paid-for entertainment counts as value; it has "psychic and other intangible values." *In re Chomakos*, 69 F.3d 769, 772 (6th Cir. 1995). Services count as value. *See, e.g., In re Investors Funding Corp.*, 523 F. Supp. 533, 549–50 (S.D.N.Y. 1980).

Members who contribute to churches receive from the church all the benefits of religion, including worship services, other pastoral services, and the use of a physical facility in which to worship. These benefits and services are of great value to many contributors, and they are of constitutional value under the Free Exercise Clause. That courts cannot constitutionally quantify the value of religious benefits and services does not mean that these services have no value. Religious services could not be resold for cash, but that does not distinguish them from most other services provided to consumers. Most consumer expenditures provide value of some sort to the consumers, but very few consumer expenditures provide any value to the consumers' creditors. Services and perishables are quickly consumed; most consumer "durables" rapidly depreciate; homes and many other consumer purchases are exempt from the claims of creditors. If religious services are of value to the debtors, it is irrelevant that they cannot be converted to cash for creditors.

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Some courts have conceded that church members receive value from their churches, but they hold that the value that debtors receive from the church is not in exchange for the debtors' contributions. That is, they hold that members in financial difficulty should take advantage of the church, accepting its benefits and consuming its services without contributing to the cost of producing those benefits and services. This wooden interpretation of "in exchange for" is error. *See In re Young*, 89 F.3d 494, 495 (8th Cir. 1996) (Beam, J., concurring in denial of rehearing en banc); *In re Moses*, 59 B.R. 815 (Bankr. N.D. Ga. 1986); *In re Missionary Baptist Found.*, 24 B.R. 973 (Bankr. N.D. Tex. 1982). If church members collectively did not contribute, the church could not exist, and the debtors would have received no valuable religious benefits or services from the church. The debtors contributed their fair share, calculated in accordance with their understanding of religious obligation, to the cost of benefits and services that they valued highly. The congregation and each member received religious benefits and services in exchange for the congregation's, and therefore each member's, contributions. This transaction is different in kind from the fraudulent transactions that §548(a)(2) is designed to detect. The bills now pending before the Committee are intended to correct the error and dispense with judicial examination of the exchange of value between worshipers and their churches.

The law of contracts has long treated charitable contributions in a way that is analogous to how they would be treated under the pending proposals. In general, a contract is not enforceable without consideration. Courts do not examine the adequacy of consideration in ordinary contract cases, so the requirement has not been "fair consideration" or "reasonably equivalent value" as in fraudulent transfer law. But there must be some consideration, and in the case of simple promise to make a charitable contribution, there appears to be none.

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Even so, most courts have long recognized that the policy of requiring consideration does not apply here, that it would be a mistake to unthinkingly apply commercial norms to charitable transactions, and that this important class of promises should be enforceable. Nearly every state makes an oral or written promise to contribute to a charity legally enforceable, without consideration, and either without reliance or with thin or fictional reliance.(see footnote 1)

If reliance on a mere promise to make a charitable contribution creates an enforceable exchange at common law, then a *fortiori,* reliance on a completed charitable contribution should be treated as an exchange. The emerging misinterpretation of fraudulent transfer law is thus inconsistent with long-settled common law on promises to contribute. In the typical bankruptcy case, the debtors have made their customary contributions, week after week, and the church has relied in the most emphatic and unambiguous way—it has spent the money. It has spent the money on services that the contributing member uses and values. The member's contributions are thus part of an exchange of values. And both the member and the church consider the values they exchange to be reasonably equivalent. Without or without proof of an express exchange for value, completed charitable gifts should not be deemed fraudulent.

Dispensing with any requirement of an exchange of value in the case of charitable contributions challenged under §548(a)(2) is consistent, both in law and in policy, with the rule that the Commissioner of Internal Revenue may disallow charitable-contribution deductions for payments made in exchange for specific benefits. (This rule was announced in *Hernandez* v. *Commissioner,* 490 U.S. 680 (1989), interpreting 26 U.S.C. §170 (1994). In fact, the Commissioner generally allows deductions for payments made even in explicit exchange for religious benefits that lack market value. Rev. Rul. 70–47, 1970–1 Cum. Bull. 49; *see Powell* v. *United States,* 945 F.2d 374 (11th Cir. 1991)).

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Contributions to churches, made in the general expectation of receiving religious benefits and services from the church, may be treated as gifts under the Internal Revenue Code and as exchanges under the Bankruptcy Code, if the treatment under each Code is consistent with that Code's policy. In fact, a common policy would underlie both provisions: In the case of charitable, educational, and religious organizations that depend on contributions from their members, both tax deductibility and nonliability to fraudulent transfer claims encourage contributions and discourage "free riders" who take advantage of the opportunity to benefit without contributing. The emerging judicial interpretation of the Bankruptcy Code virtually requires church members facing financial risks to free ride, a result that is seriously inconsistent with the Internal Revenue Code's policy of rewarding those who do not free ride. Congress could remove even the appearance of an anomaly here by simply dispensing with the value requirement for charitable contributions challenged under §548(a)(2).

In another context in which a wooden reading of §548(a)(2) had unintended consequences, the Supreme Court held that §548(a)(2) should not be interpreted "to disrupt the ancient harmony" of long settled understandings of proper behavior by debtors and creditors. *BFP* v. *Resolution Trust Co.,* 511 U.S. 531, 543 (1994). In *BFP,* the Court held that §548(a)(2) does not invalidate the long-established practice of bidding far less than the market value of property at foreclosure sales, and the Court emphasized that "reasonably equivalent value" does not mean market value. *Id.* at 547. The Court noted the four-hundred-year history of the badges of fraud doctrine, and noted that no court had applied it to foreclosure sales until 1980. *Id.* at 540–42. Similar considerations should have applied to charitable contributions in ordinary course. There is no basis for the judicial distinction between the ancient practice of foreclosure sales and the even more ancient practice of religious and charitable contributions.

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The emerging judicial interpretation of "in exchange for" also distinguishes churches from secular groups, on the ground of a feature that is essential to churches. Every private club or association must raise money to support its operations. Secular clubs generally charges dues for membership and fees for services; members who do not pay are excluded. Thus, debtors who pay monthly dues to their country club have not made a fraudulent transfer; these dues are in exchange for club membership and the right to use club services.

Monthly contributions to their church served the same economic function for the church as payments of dues and fees to a country club: they enable the association to function. But churches cannot exclude those who fail to pay; such a policy would eliminate evangelism and charitable works, and thus fundamentally change the nature and mission of most churches. So the courts are interpreting §548(a)(2) to apply to these contributions because of—*solely and precisely because of*—a practice that is essential to the mission and structure of churches. This discrimination against

religious practice should require compelling justification under the Free Exercise Clause. *Church of the Lukumi Babalu Aye, Inc.* v. *City of Hialeah*, 508 U.S. 520 (1993); *Employment Div.* v. *Smith*, 494 U.S. 872 (1990). But it is simpler for Congress to clarify the statute.

The emerging judicial interpretation of §548(a)(2) also discriminates against religion in other ways, some of which further reveal that the interpretation is a misinterpretation. Section 547 authorizes the trustee to recover certain transfers that prefer some creditors over others, but not if the transfer was "made in the ordinary course of the business or financial affairs of the debtor and the transferee." 11 U.S.C. §547(c)(2) (1994). Thus, regular monthly payments to a preferred creditor are not recoverable, because there is nothing suspicious about continuing a series of payments in ordinary course.

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There is no comparable ordinary-course exception in §548(a)(2), even though there is nothing suspicious about continuing a series of contributions in ordinary course. The reason there is no ordinary-course exception in §548(a)(2) is that the section was never intended to apply to ordinary-course transactions that raised no suspicion of fraud. The suspicious transactions Congress was thinking about were necessarily out of ordinary course. A case where the debtor suddenly gave a large portion of his assets to his church on the eve of bankruptcy would raise suspicions; the contribution would not be in ordinary course, and the timing and irregularity of the transaction might be badges of fraud, supporting a possible inference of intent to hinder creditors under §548(a)(1). The routine weekly or monthly contribution raises no such suspicions, and is entirely outside the proper scope of §548(a)(2).

The emerging judicial interpretation of §548(a)(2) also creates discriminatory rules about what debtors can do with their property in the year preceding bankruptcy. The general rule in bankruptcy is that the debtors control the disposition of their funds prior to bankruptcy. The debtors' money is *not* the property of the unsecured creditors; it remains the property of the debtors until the creation of a bankruptcy estate. 11 U.S.C. §541 (1994). Section 548(a) recognizes the debtors' ownership; it expressly and exclusively applies only to transfers "of an interest *of the debtor* in property." Debtors can and do spend their money in all sorts of ways that produce value to them, but no value to their creditors. Indeed, this pattern of spending is the essence of why debtors go bankrupt.

These other expenditures that produce no value for creditors are not fraudulent transfers recoverable by trustees in bankruptcy, even in extreme cases. Thus, debtors who gamble their money away in casinos have not committed a fraudulent transfer. *In re Chomakos*, 69 F.3d 769 (6th Cir. 1995). Debtors who waste their money on travel, fine meals, alcohol, or prostitutes all receive something in return, and thus have not committed fraudulent transfers. Debtors who spend all their money on exempt property have not committed fraudulent transfers, even though they deprive their creditors of all value in their property. *See, e.g., In re Armstrong*, 931 F.2d 1233 (8th Cir. 1991).

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My employer invests more than 15% of my salary into my retirement account; I can add additional sums voluntarily; and all earnings are reinvested without limit. If I later fall on hard times and go bankrupt, I get to keep all that money, because retirement plans are exempt from my creditors. But the comparable percentages that I give to charity each year may be recovered from the charities, who took the gifts in good faith and did no wrong to anyone. Contributions to charity and contributions to my retirement account have identical effects on my creditors; it is bizarre to make the charity pay my creditors when I do not have to pay them myself.

The general rule is that the Bankruptcy Code protects debtors' discretion to use their own money prior to bankruptcy. One of the very few things debtors cannot do, under the emerging judicial interpretation, is give money to their church.

The result of these rules is that some 96% of chapter 7 bankruptcies are no-asset cases. Michael J. Herbert & Domenic E. Pacitti, *Down and Out in Richmond, Virginia: The Distribution of Assets in Chapter 7 Bankruptcy Proceedings Closed During 1984–1987*, 22 U. Rich. L. Rev. 303, 310–11 & n.30 (1988) (reporting local and national data). Non-tithing debtors dissipate their funds in other ways; there is no basis to believe that creditors would get more

if debtors were prevented from tithing, and thus no basis for the belief that the creditors' money somehow went to the church. To the contrary: creditors benefit from the emerging judicial interpretation only if debtors *do* tithe and thus enable trustees to sue churches. Courts are holding that contributions to churches create a pool of liability that otherwise would not exist. The emerging judicial interpretation would make churches the principal source of funds for distribution in individual bankruptcies.

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III. Contributions to Secular Charities

I have focused on contributions to churches, because that is where the litigation is. Few contributions to secular charities have been challenged. But the bill should apply to secular charities as well, just in case. Some of the same arguments apply; some do not. But routine charitable contributions to secular charities are no more fraudulent than routine contributions to churches, and in this situation, it is better policy to relieve all charities from a misinterpretation of the rule than to relieve only some.

Protecting all charities will also avoid much unnecessary litigation. Trustees are arguing that it would violate the Establishment Clause to protect churches without protecting secular charities. I think that argument is wrong, but it will take much litigation to finally resolve the issue. Congress can avoid all that litigation if it protects secular and religious charities alike.

IV. Solving the Problem

This body of law is highly technical, and trustees and creditors have multiple theories available to impose liability on churches and other charities. Solving the problem requires a complex and multi-part bill. Neither bill before the Committee is quite there yet, but H.R. 2604 comes very close.

Fraudulent transfer claims against churches can be brought in federal court under federal law via §548(a)(2), in federal court under state law via 11 U.S.C. §544 (1994), or in state court under state law. The *Cedar Bayou* case is proceeding in state court, on all three theories, after the federal bankruptcy case was closed. But it is the federal bankruptcy provision that has triggered these actions, in *Cedar Bayou* and in all the other cases. These actions were never brought under state law before the emerging misinterpretation of federal bankruptcy law. Congress should close off all these avenues of attack on ordinary-course charitable contributions. The final bill should preclude these actions under §548(a)(2), preclude them under §544, and preclude them from proceeding under state law outside the bankruptcy court in cases where a bankruptcy case has been filed.

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H.R. 2604 solves the problem under §548(a)(2), and it solves the problem under §544(b). H.R. 2611 does not address the problem under §544(b), and therefore, H.R. 2611 would do no good whatever in its current form. Trustees would simply file under §544(b) in every case. I also believe that H.R. 2604 does a better job with respect to §548(a)(2), leaving fewer opportunities further litigation. Sections 4, 5, and 6 of H.R. 2604, discussed below, solve important problems that are not addressed by H.R. 2611.

V. An Essential Addition

Neither bill addresses the risk that individual creditors may file under state fraudulent transfer laws. If the effect of cutting off the claim in bankruptcy is simply to move the claim to state court, Congress will have accomplished nothing. I do not know how often that will happen, but it is likely to happen whenever there is at least one creditor with a large claim. It will be more likely to happen if the amount of the contributions is large, and those are the cases of greatest concern to churches and charities.

Here is how the problem arises: The current draft of H.R. 2604 cuts off the trustee's claims under §544(b) and

§548(a)(2), so the trustee cannot sue. The trustee has no claim, and neither the claim nor the money will ever become property of the estate. An individual creditor who sues the church or charity would thus would not be interfering either with the trustee or with property of the estate. So the current draft actually frees up the individual creditors to sue without waiting for the end of the bankruptcy proceeding. Any individual creditor could sue a church or other charity protected by the current draft of H.R. 2604. Instead of one potential plaintiff—the trustee—there would be many potential plaintiffs—every individual creditor

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This result would plainly be inconsistent with general bankruptcy policy, and inconsistent with the purpose of H.R. 2604. The usual bankruptcy policy is that once a bankruptcy proceeding is filed, creditors must abandon efforts to collect outside the bankruptcy court. This policy is achieved by prohibiting claims against the debtor and claims against property of the estate. These claims are barred even though they are state law claims and even though they would be filed in state court. The same policy applies here; if Congress enacts a new rule governing these claims against churches in bankruptcy courts, it should not be possible to evade that rule by filing the same claims elsewhere.

I have drafted proposed language to solve this problem. At the end of §3(b)(2) of H.R. 2604, add the following:

Any claim to recover such a transfer, brought by any person, under state or federal law, in state court or in federal court, whether filed before or after the commencement of the case, is preempted as of the commencement of the case.

This language does not preempt any state claim until and unless a bankruptcy proceeding is filed. That is, the language I have suggested is not a Commerce Clause preemption that applies in all circumstances. It is confined to the Bankruptcy Clause function of specifying what happens once a debtor is in bankruptcy. Individual creditors can sue churches under state law before bankruptcy, and nothing in the pending bills or in my proposed addition would change that. But the fact is that individual creditors have not sued prior to bankruptcy. In the real world, this problem has been created by federal bankruptcy law. If you really fix it in cases subject to the bankruptcy power, and don't just move it around, you will probably have fixed it everywhere.

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There is no doubt of constitutional power or propriety. Bankruptcy law inherently preempts state-law collection remedies. This preemption is very broad; it applies to all actions against the debtor and all actions against property of the estate. H.R. 2604 will cause a narrow set of fraudulent transfer claims to fall just outside the language of the existing preemption provisions, but not outside their policy. My proposed addition to H.R. 2604 would correct this glitch, and it would make "uniform Laws on the subject of Bankruptcies throughout the United States," U.S. Const., Art. I, §8[4]. My insertion would assure a uniform result once a bankruptcy petition was filed; it would not let individual creditors evade the Bankruptcy Code by filing outside the Bankruptcy Court.

VI. The Other Provisions of H.R. 2604.

H.R. 2604 has three additional provisions (§4, 5, and 6) not contained in H.R. 2611. These provisions do important work and should be included in any final bill.

Section 4 solves the problem of religious and charitable contributions in partial payment cases under §13. It provides that debtors in chapter 13 may include religious or charitable contributions in their budgets, subject to the limits already specified in §2 for the §548(a)(2) cases. Debtors are permitted budgets for recreation and other discretionary expenditures; those debtors who feel obliged to support their church should be permitted to do so. There is no legitimate basis by which judges can say that it is reasonably necessary to pay for a movie on Saturday night but not to contribute to one's church on Sunday morning.

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Section 5 will avoid unnecessary litigation about application to pending cases, and it will enact the right answer. This bill should apply to all cases not yet resolved by final judgment, because it is correcting an unanticipated judicial misinterpretation of prior law. Correcting legislative drafting errors and judicial misinterpretations are accepted reasons for applying new statutes to pending cases.

Section 6 avoids any unintended ambiguity, and will thus avoid litigation, over the relationship between this bill and the Religious Freedom Restoration Act, 42 U.S.C. §2000bb et seq. (1994). (There appears to be a typographical error in the bill; RFRA is cited as §2002bb, at least in the version on the World Wide Web.) RFRA remains valid as applied to federal law, and Congress should not unwittingly do anything that implies otherwise. Section 6 is therefore a useful precaution.

Mr. **GEKAS.** We thank the gentleman. We turn to Dr. Goold.

The questioning will begin when the members of the panel have completed their testimony.

Dr. Goold.

STATEMENT OF STEPHEN PAUL GOOLD, SENIOR PASTOR, CRYSTAL EVANGELICAL FREE CHURCH

Mr. **GOOLD.** Thank you, Mr. Chairman, and thank you for the opportunity of appearing today before your subcommittee to discuss this issue of profound importance, a matter with which I am intimately, personally acquainted.

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I speak today as senior pastor of Crystal Evangelical Free Church in Minneapolis. For over 6 years now, our church has fought a legal battle to preserve the religious freedom of biblical tithing.

Ours has been a struggle to prevent the weekly tithes and offerings voluntarily given by a couple, previous to filing bankruptcy, from being declared by the courts to be "fraudulent transfers" and ordered returned to the creditors.

The financial cost to the church of this protracted battle has been staggering, in excess of $300,000. The emotional experience to the devout family voluntarily practicing a biblical tithe in the free exercise of their religious faith has been painful. The intimidating effect upon countless others in terms of the free exercise of their religious practice is ominous.

Our case was the first in what has now become hundreds of bad applications of good law. In 1992, as you know, for the first time in our nation's history, a bankruptcy trustee successfully recovered funds willfully donated to the church by members of the congregation who were subsequently forced to file bankruptcy.

The court held that any spiritual benefits that donors receive as a result of their association with the church did not constitute reasonably equivalent value for their donations and was therefore fraudulent transfer.

This ruling was made in spite of the court's own admission that actual fraudulent transfer was not intended or evident in any way.

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Additionally, in an unprecedented manner, the courts rigidly applied present bankruptcy law to the free exercise of religion by holding that only benefits which are tangible or which have some economic value can constitute reasonably equivalent value in exchange for voluntarily given tithes, offerings, and donations.

Until 1992, our present Bankruptcy Code served us well when it was applied in the spirit and with the intent for which it was adopted. But the convoluted conclusions now being reached by the courts impose restrictions upon the

church and the personal practice of religious freedom based on the application of technical language doubtfully intended to be used in this way.

For example, the code states no fraud or improper conduct is required for conveyance to be set aside as fraudulent transfer. In other words, there doesn't have to be any fraud or even any implications of fraud for tithing, religious, and charitable donations to be called fraud under the current misapplication of existing Bankruptcy Code.

This is wrong, but it is how the sincere tithes and donations given in the free exercise of religion can simply be declared to be fraudulent transfer under this new and wrong application of existing law, forcing a church or a charitable organization to return the donations to the trustee even though nothing improper has been done.

By the way, I might add that contrary to Representative Chenoweth's statement that she was unaware, I am aware that these misapplications have moved into the realm of charitable organizations. A very good friend of mine, Tom Phillips, who heads International Student Fellowship encountered the same dilemma. It cost him $50,000, and it nearly put them under. It has moved into nonprofit charitable organizations.

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In our case the donors regularly gave to the church in an established pattern for 10 years previous to bankruptcy, with no question about their sincerity in making voluntary contributions. Their tithes were nevertheless voided as fraudulent transfers solely because the court viewed the religious donations as mere economic transactions with no value received in return.

To reduce the practice of religious faith as having no value because the value isn't tangible is absurd. It is also inconsistent with the spirit and the intent of the First Amendment and our 400-year-old bankruptcy codes, which have harmoniously existed with religious and charitable organizations until 1992.

Furthermore, millions of devout believers are compelled by an inward value and an esteem of God to willfully follow his instructions for living as revealed in the scriptures. Doing this in the form of a biblical tithe should not bring the church or the individual into contest with the state, if the donor later experiences financial bankruptcy.

The call to prioritize tithes and offerings to God and to generously share with others is not a new thing. It is a 4,000-year-old Judeo-Christian injunction from the scriptures. However, calling biblical tithes and offerings "fraudulent transfer" is a new thing, and bringing this practice into contest against the laws of the United States is a new thing.

I will close by saying that being immersed in this issue for over 6 years and investing over $300,000 in the process, I strongly suggest the wisdom of H.R. 2604, the Religious Liberty and Charitable Donation Protection Act of 1997.

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I believe H.R. 2604 is considerably more comprehensive in its provisions for appropriate change than H.R. 2611.

[The prepared statement of Mr. Goold follows:]

PREPARED STATEMENT OF STEPHEN PAUL GOOLD, SENIOR PASTOR, CRYSTAL EVANGELICAL FREE CHURCH

INTRODUCTORY OVERVIEW AND CASE HISTORY

From February 1991 through January 1992, Bruce and Nancy Young, members of the Crystal Evangelical Free Church in Minneapolis, Minnesota, suffered serious financial reverses in their 20 year old family run electrical contracting business. The reversal in finances was due in part to Mr. Young's ill health (he had a heart attack during the year), and the national economic recession. During that year, the Youngs sold several assets which would have

been exempt under the Bankruptcy Code, refinanced their house, and attempted to pay off their business debts. In January of 1992, when faced with the impossibility of paying their business creditors, they were counseled to file bankruptcy. The Youngs resisted this idea for as long as they could, but eventually came to the realization that this was their only viable course of action.

During the preceding year the Young family continued to tithe 10% of their gross personal family income to the Crystal Evangelical Free Church, on a weekly basis, as they had for ten previous years. This practice was a voluntary outgrowth of their personal religious faith and biblical persuasions. The Youngs revealed these contributions, as was required under law, on the bankruptcy forms. The Bankruptcy Trustee subsequently requested that the church turn over the Young's voluntary tithe contributions to her. The church contested, and litigation was started by the Bankruptcy Trustee in the Spring of 1992.

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The Bankruptcy Trustee began a turnover motion under 11 U.S.C. Section 542 (Section 542 of the Bankruptcy Code) against Crystal Evangelical Free Church in May of 1992, demanding the return of the tithes given during a period of one year prior to filing bankruptcy. This action was initiated based on 11 U.S.C. Sec. 548(A)(2) which provides that any transfer of assets within the year prior to the filing of the bankruptcy, where no reasonably equivalent value was made and where the debtor was insolvent on the date such transfer was made, is subject to having the Trustee pull those assets back into the bankruptcy estate. This section of the Bankruptcy Code (Sec. 548) is entitled "Fraudulent Transfers and Obligations." The original counsel for Crystal Evangelical Free Church decided that in fighting the motion brought by Trustee that they would rely strictly on two prior cases in other Bankruptcy Courts involving the same situation, both of which had found that reasonably equivalent value had been returned to a bankruptcy debtor for religious contributions made within a year prior to the filing of the bankruptcy. No Religious Freedom issues were brought out by the original attorneys for the church at the Bankruptcy Court level.

The Trustee brought a motion for summary judgment, and the church's counsel brought a cross-motion for summary judgment. These motions were heard in October of 1992 in the Bankruptcy Court for the District of Minnesota. The Chief Judge issued a ruling in favor of the Bankruptcy Trustee based solely on statutory theory, requiring the church to return the tithe donations. The decision was issued on December 20, 1992, and constituted a precedent-setting ruling in the history of U.S. and European bankruptcy law. **The conscientious exercise of the donor's personal religious practice through tithing was deemed by the court to constitute ''fraudulent transfer'' by virtue of the application of bankruptcy codes never intended to restrict religious freedom.**

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Crystal Evangelical Free Church appealed the ruling to the U.S. District Court and secured new legal counsel. In April 1993, the District Court judge affirmed the ruling of the Bankruptcy Court. Appeal was then filed with the Eighth Circuit Federal Court of Appeals, along with an Amicus brief supported by multiple denominations and organizations representing at least 40 million Americans.

Shortly after the filing of the final Reply brief in September of 1993, The Religious Freedom Restoration Act (RFRA) was passed and signed into law by President Clinton.

The church immediately filed a motion with the Eighth Circuit to file a Supplemental brief arguing that RFRA applied to the case and the motion was granted.

On May 6, 1996, the Eighth Circuit opinion was issued, finding in favor of the Church, on the basis of the Religious Freedom Restoration Act. On September 20, 1996, appeal was made to the Supreme Court of the United States by the Bankruptcy Trustee.

The case was held by the Supreme Court until June 27, 1997, when the Eighth Circuit's favorable opinion for the church was vacated and remanded for rehearing after the Supreme Court struck down state application of RFRA. The

case was subsequently heard again before the Eighth Circuit on December 8, 1997. A decision has not yet been rendered at this time.

CENTRAL THESIS

Total cost to the church to date, for this six year defense of the donor's right to practice their religious faith in the form of a tithe and to defend against this precedent-setting misapplication of 400 year old European/American bankruptcy laws, is in excess of $300,000! This procedure has been a severe infringement upon the donor's free exercise of their personal religious freedom and a substantial financial burden upon the church. With the Supreme Court having struck down RFRA, the primary protection for religious freedom available to citizens through federal law, thereby rejecting the judgment of Congress and asserting that the judicial branch, not the legislative branch, is exclusively authorized to interpret the Constitution's guarantee for religious freedom, a specific and proactive response from Congress is imperative. **Section 548(A)(2) of the Bankruptcy Code must be amended by providing an exception for religious and charitable donations.**

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THE DOMINO EFFECT UPON CHURCHES

The term "church" can be used interchangeably with synagogue or temple or any house of worship for the remainder of this testimony.

The case being cited, (RE: *Julia A. Christians* v. *Crystal Evangelical Free Church*) was the first ruling to apply bankruptcy law, intended to prevent fraudulent transfer of funds, in an intrusive manner upon religious tithing and donations where fraud is clearly not evident or intended. It is bad application of good law, and has resulted in a plethora of similar cases in a short time. To date, there are scores of Crystal Evangelical Free Church "type" cases now in the courts, with new ones being placed into the judicial pipeline on an almost daily basis. Many of these cases have reached the level of the Circuit Courts. The Crystal Evangelical Free Church decision, which has now been vacated, is the only Circuit Court opinion in a case of this type which is favorable to individual donors and their churches. With the loss of RFRA, the standing of this important case upon rehearing before the Circuit Court appears fragile at best. Regarding the application of bankruptcy law, the courts are seemingly bent upon eliminating any consideration of the uniqueness of the church or the sanctity of the practice of personal religious freedoms in the form of tithing and religious donations. This alarming trend has developed in only the last six years of our country's 221 year history.

THE BURDEN AND DANGER OF THE MISAPPLICATION OF CURRENT BANKRUPTCY CODES

An example of the inequity of what is happening is found in the judicial reasoning undergirding the lower court's decisions. The court held that any spiritual benefits that donors received as a result of their membership in church did not constitute "reasonably equivalent value" for their donations, and was therefore "fraudulent transfer." This ruling was made in spite of the court's admission that actual fraudulent transfer was not intended or evident in any way.

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Such a convoluted conclusion was rendered by the court because of technical application of current bankruptcy codes which state, "No fraud or other improper conduct is required for conveyance to be set aside as 'fraudulent transfer.' " In other words, there doesn't have to be any fraud for it to be called fraud if the court wants to rule it to be fraudulent. This is how the financial giving of devout believers can simply be declared as "fraudulent transfer" and now garnished from the church by the courts.

Additionally, current code reads, "Only benefits which are tangible or which have some economic value can constitute 'reasonably equivalent value' for alleged fraudulent transfer.' "

If the courts now choose to apply such language in a manner that determines the practice of personal

religious faith through the 4000 year old Judeo/Christian injunction of tithing to be ''fraudulent transfer''—then the Bankruptcy Code must be rewritten to provide statutory exception for religious and charitable donations. To reduce the practice of religious faith to having no value because the value isn't tangible is patently absurd. However, individuals and churches across the nation are now being subject to this judicial myopia.

THE OMINOUS IMPLICATIONS

The court's rulings have the effect of greatly increasing the scope of fraudulent transfer by applying it for the first time to religious and charitable donations. For over 400 years, "value" for religious and charitable donations was not even an issue until trustees recently sought to use the Bankruptcy Code in a manner and application that tramples religious freedom, while the courts imply commitment to the spiritual well-being of people to be of no value because it is not tangible.

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The result of this trend will be the wholesale depravation of the rights of any devout religious believers who find themselves in bankruptcy, and could in many cases seriously disrupt the budgets and programs of churches.

An additional consideration is the possible impact outside the bankruptcy setting. The section of the Bankruptcy Code that is being primarily used in the cases against churches is a codification of a portion of the Uniform Fraudulent Conveyance Act and the newer Uniform Fraudulent Transfer Act. **If this new trend is not curtailed, it is a very short step to allow any creditor who has a judgment against anyone who has given money to a church to begin using these recent decisions as a method of attempting to collect a judgment through garnishment on the church, even if the person who owes the money is not in bankruptcy.** Even worse, these statutes allow a creditor to go after contributions that were made to a church up to five and six years earlier. This will have a severe intimidating effect upon individuals and churches.

THE ROLE AND PLACE OF THE CHURCH AND ITS ENTITLEMENT TO UNIQUE CIVIL TREATMENT

Churches have special claims to make that are peculiar to themselves and that are based upon considerations that do not apply to other organizations.

One reason they are distinguishable is that they embody the activity protected by the First Amendment's initial clauses; the free exercise of religion and its non-establishment in any specific way by government. If one were to look for the most visible, extensive, and enduring collective manifestations of the "free exercise of religion" in this country, where else would one look but to the institutions which inculcate, amplify, and perpetuate religious behavior. The Church is an ongoing community of faith with revered teachings, sacred rites and sacraments, and respected teachers trained in the practice of faith. In that sense, churches are an important and indispensable part of whatever it is the first two clauses of the First Amendment are designed to protect under the rubric of "religion."

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The Supreme Court has historically interpreted the First Amendment to mean that no governmental entity in the land may sponsor, support, prefer or inhibit any religion, or all religion in America. This provision is unique. There is no such restriction upon government with respect to any other activities protected by the First Amendment.

The ministrations of the Church are not without value, and should not be subject to codes with application based on value that is only temporally determined. They are, on the contrary, advantageous not only to their members, but to the society as a whole. That is a sweeping claim reflected intuitively by the First Amendment's religion clauses. It is religion, primarily embodied in the Church, that ministers to people, addressing the needs of the inner person in all the successive transitions of life; birth, puberty, marriage, emotional crisis, illness, bereavement, dying and eternity. When Americans exercise various aspects of their personal religious faith as taught to them by their church, they are in most cases reflecting their allegiance to the Living God as they understand His call upon their life through the authority of

the Holy Bible. Provision must be made for everyone who desires to genuinely follow what they purposefully view as their highest calling, irrespective of the intrusion of present Bankruptcy Code.

CONCLUSION

With its own unique, important and limited task and function, and in view of the present judicial trend to intrusively apply strict wording of the present Bankruptcy Codes in a manner devoid of historically recognized intent and purpose, Churches, all houses of worship and charitable organizations deserve the consideration of special protection afforded by an amendment to Section 548(A)(2) of the Bankruptcy Code to provide statutory exception for religious donations. HR 2604, the Religious Liberty and Charitable Donations Protection Act of 1997, offers comprehensive inclusive and appropriate protection.

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Mr. **GEKAS.** We thank the gentleman and will return to him during the question-and-answer period.

Mr. McFarland.

STATEMENT OF STEVEN T. MCFARLAND, ESQ., DIRECTOR, CENTER FOR LAW AND RELIGIOUS FREEDOM

Mr. **MCFARLAND.** Thank you, Mr. Chairman. On behalf of the 3,000 member attorneys of the Christian Legal Society, I want to thank you for the opportunity of addressing this and say that it is no overstatement to say that every charity, every church, every religious social service ministry in America is presently threatened and indeed defenseless and uniformly losing in this area of the law.

We hear from and are involved in cases from Connecticut to Oregon, from Minnesota to Texas. I heard this week from North Carolina, a First Baptist Church outside of Raleigh. All over the country, from Pennsylvania to Kansas, churches are being sued. And uniformly, the common denominator is that the churches are losing.

Exhibit 1 to our testimony is an example of the kind of demand letter that trustees are sending to churches, and churches frequently are rolling over, so for every reported case, there are probably ten in which the church or religious ministry has simply written a check to the trustee.

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Pastor Goold had the spine and the principle and the wherewithal to resist it, and we are grateful that he has.

Let me address, if I may, several suggested improvements, some of which have been addressed.

One is, both bills, H.R. 2604 and H.R. 2611, need to preempt suits by third parties using state fraudulent transfer law, and Professor Laycock alluded to this a moment ago.

Presently, H.R. 2604 would fix the problem under section 544 of a trustee using state fraudulent transfer law, which, as in the case of Minnesota can go back 6 years prior to the filing of bankruptcy. However, there is nothing to preclude third-party creditors from going back the same number of 1, 2, 3, 6 years as they did in Houston. The Cedar Bayou Baptist Church is now looking at a $50,000 bill. Because section 544 can be wielded by both third-party creditors as well as the trustees, that loophole needs to be closed.

In addition, while we strongly support H.R. 2604, H.R. 2611 has several needed improvements. One is that it only provides protection for those who give under a "sense of religious obligation." We would suggest that the word "obligation" be replaced with the word "motivation."

There are many, and indeed, I would suggest most, denominations within the Christian religion that encourage but do not necessarily require tithing, and we would hate to see bankruptcy judges getting around the remedy that this committee would put forward by simply saying, "well, there wasn't a sense of religious obligation, they can choose how much they give, so it is not an obligation."

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Secondly, as to H.R. 2611, we would suggest that it extend to Chapter 13, post-petition giving. The same motivation, the same scriptural injunction applies whether you file for bankruptcy or not.

Finally, as to the issue of including secular charities, yes, the problem has primarily found its place among churchesin the last 5, 6 years. However, while I agree with Professor Laycock that there isn't a winnable Establishment Clause challenge, we don't want to enrich lawyers like ourselves for ad nauseam litigation over that question. It would be far safer for this subcommittee to go with H.R. 2604 and extend protection both to religious as well as charitable and educational institutions.

We would encourage the addition to section 2 of the word "educational." While it is included in 170(c), it would be helpful to have it expressly stated that a gift to a religious school is protected here.

Finally, let me address the question of, well, is this a special interest exception. Answer: no more so than the religious freedom clause of the First Amendment requires. The framers of our Constitution permit, if not require, this kind of protection for church autonomy. And I don't believe that Congresswoman Chenoweth's concern about a slippery slope toward government incursions and regulations will materialize just by adding secular charities.

The issue here is church autonomy; the problem is primarily with imposition on religious freedom. Let us solve the problem in a comprehensive way, avoiding Establishment Clause problems, addressing Chapter 13, addressing the state fraudulent conveyance laws so we don't have to come here again, and the church can get back to religious ministry rather than bankruptcy court.

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Thank you very much, Mr. Chairman.

[The prepared statement of Mr. McFarland follows:]

PREPARED STATEMENT OF STEVEN T. MCFARLAND, ESQ., DIRECTOR, CENTER FOR LAW AND RELIGIOUS FREEDOM

Thank you, Mr. Chairman, for the invitation to comment regarding the proposed legislation to amend the bankruptcy code for the sake of religious and other charitable organizations. The Christian Legal Society (CLS) is a thirty-six-year-old organization of 4,000 Christian attorneys and law students nationwide. Its Center for Law and Religious Freedom has worked for religious liberty on behalf of all faiths in every level of the judicial, legislative and executive branches of state and federal government. The Center has particular expertise on the issue of bankruptcy trustees' seeking to recover tithes and offerings to churches. The CLS Center filed four amicus briefs with the U.S. Court of Appeals for the Eighth Circuit in the most important federal case in this area—*Christians* v. *Crystal Evangelical Free Church.* Moreover, CLS helped to persuade the White House to order the withdrawal of the Justice Department's ill-advised support for the bankruptcy trustee in that case. Through our public interest law firm, the Western Center For Law And Religious Freedom, we presently represent churches in Seattle, Washington, Portland, Oregon, and Klamath Falls, Oregon under attack by bankruptcy trustees. And CLS has assisted our member attorneys representing churches in similar cases in Idaho, North Carolina and Pennsylvania.

Our testimony will focus on three issues:

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First, why is legislation such as this needed, or, is anything broken?

Second, should charitable contributions to religious and charitable organizations be treated specially, or, is this the proper fix?

Finally, do specific provisions of the current proposals by Reps. Packard and Chenoweth (H.R. 2604 and 2611) strike the proper balance, or, do they accomplish the "fix"?

1. Federal legislation is immediately needed to protect the fundamental rights and autonomy of churches and religious ministries.

Congressional action is vitally necessary in this area because: a) the First Amendment affords little protection to religious organizations; b) federal statutory law may no longer extend them relief either; and c) the plain meaning of current code sections will ensure that churches continue to lose their tithes and offerings to creditors.

1.1 *The First Amendment affords little protection for religious charitable donees.* Since 1990, when the U.S. Supreme Court drastically reinterpreted the Free Exercise of Religion clause(see footnote 2), that clause of the First Amendment has been of little use to churches, synagogues and parachurch ministries. In the *Smith* decision, the high court ruled that the Free Exercise clause cannot be invoked against a law that is facially neutral as to religion and generally applies to all persons, even if the effect of the law substantially burdens religious faith or practice. Section 548(a)(2) of the Bankruptcy Code does not target religion specifically; it applies generally to all bankruptcy petitioners. Consequently, courts across the land have found no free exercise problem with a bankruptcy trustee confiscating tithes and offerings, even when given in good faith to churches well prior to the filing of bankruptcy by the parishioner.(see footnote 3)

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Neither has the Establishment Clause of the First Amendment to the U.S. Constitution provided any relief to churches or religious ministries. In *Christians* v. *Crystal Evangelical Free Church*, the federal district court held that the Establishment Clause was not violated by invocation of §548 against a church's offering plate. The court, applying the traditional *Lemon* test,(see footnote 4) found that §548 had a secular purpose (to maximize the size of the bankrupt's estate), that its primary effect was not to promote religion (a mere suit to enforce a statute would not inhibit religion, the court said), and that routine enforcement did not involve an excessive entanglement with religious doctrine.(see footnote 5)

1.2 *The Religious Freedom Restoration Act is arguably still applicable to federal law, but not indisputably so; moreover, it has been circumvented repeatedly.*

The Religious Freedom Restoration Act (RFRA) of 1993(see footnote 6) imposes the highest legal standard of protection for religious persons and organizations whose faith is substantially burdened by government action, such as the actions of bankruptcy trustees here. However, on June 25, 1997, the U.S. Supreme Court held that in enacting RFRA Congress exceeded its power under Section 5 of the Fourteenth Amendment; RFRA is void as it applies to state law.(see footnote 7) CLS, joined by most church-state scholars, reads the Supreme Court's decision as applying only to state law, not to federal law like the bankruptcy code. But not all bankruptcy trustees share that view.

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For example, last September the First Baptist Church of Klamath Falls, Oregon, contacted our offices after they received a demand letter from a bankruptcy trustee. *See* Exhibit 1, attached. The trustee (a nonlawyer) incorrectly states that RFRA has been overturned and that consequently the church lacks any legal basis for withholding the year's worth of offerings it received from one of its members prior to bankruptcy.

Similarly, bankruptcy judges in Massachusetts and California have recently dismissed RFRA defenses raised by churches, erroneously assuming that this law has been ruled unconstitutional in *all* cases.(see footnote 8)

Obviously, churches, synagogues, mosques and religious ministries do not have the expertise to contradict such overstatements by trustees who wield the authority of federal court; neither do they have the funds to hire lawyers to contest such unfounded demands. So even though a federal law (RFRA) may provide them dispositive protection, church treasuries will continue to be invaded, either by acquiescence to trustee demands or due to the prohibitive cost of legal defense in adversary proceedings.

Moreover, even before the *Flores* decision, when RFRA's validity was not generally in doubt, courts found it to be an easily circumvented obstacle along the way to capturing pre-petition tithes.

In Kansas, a bankruptcy judge ordered the Midway Southern Baptist Church to return its offerings because RFRA is only triggered if the church could prove a substantial burden had been placed on their donating members' religious exercise. The bankruptcy judge reasoned that the trustee's action did not prevent the parishioners from tithing. So even though their money ended up in creditors' pockets rather than ministry, the debtors' religious practice had not been burdened and RFRA had not been triggered.(see footnote 9) The court also ruled, in the alternative, that even if RFRA had been triggered, that §548 serves a compelling government interest (protecting creditor interests) sufficient to deny any religious exemption.(see footnote 10)

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A federal judge in Colorado followed this reasoning last April in ruling against a Denver church.(see footnote 11)

Similarly, both the bankruptcy judge and the federal district judge in the *Crystal* case found that §548 advanced a compelling interest sufficient to justify any burden on free exercise.(see footnote 12)

Finally, another bankruptcy judge, well before the Supreme Court's *Boerne* holding, circumvented RFRA by holding it unconstitutional.(see footnote 13)

1.3 *RFRA may not be applicable to state fraudulent transfer statutes invoked by bankruptcy trustees through §544(b).*

Section 544(b) allows a bankruptcy trustee to void any transfer that would be voidable under applicable state law. Most states have adopted the uniform fraudulent transfer act which allows the voiding of transfers made as much as four years before filing for bankruptcy.(see footnote 14)

On September 10, a state court judge in Houston relied on Texas' counterpart to §548(a)(2) to order a church to pay $23,000 directly to a judgment creditor of a bankrupt church member. *See* Exhibit 2. Needless to say, churches and charities do not ordinarily have the luxury of placing large amounts of tithes in holding accounts or money market funds. The Houston church probably spent that $23,000 each week that it was given in the offering plate, and cannot easily come up with such a large sum.

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Similarly, the federal courts allowed trustees to invoke section 544(b) and the Fraudulent Transfer Acts of Colorado and Idaho against churches in those states to confiscate several years' donations.(see footnote 15)

In the wake of the *Boerne* decision by the U.S. Supreme Court, RFRA may no longer be applicable to this power of the bankruptcy trustee, because section 544 incorporates by reference a state law.

1.4 *The Bankruptcy Code must be amended if the almost unbroken losing streak of the religious community is to be reversed.*

In our research, we find at least eight reported cases in the recent past in which bankruptcy trustees have sued churches to recover tithes.(see footnote 16) The cases reveal complete geographical diversity: from Oregon to Connecticut, from Minnesota to Texas, from Pennsylvania to Colorado. But the cases are uniform in one respect: the churches virtually always lose.

The Crystal Evangelical Free Church outside of Minneapolis was ordered to return $13,450.(see footnote 17) It has incurred hundreds of thousands of dollars in defense costs in its effort to establish an important principle of church autonomy. The Midway Southern Baptist Church in Wichita, Kansas was ordered to pay $2,442.22 to a bankruptcy trustee.(see footnote 18) The Word of Life Christian Center in Littleton, Colorado last year was ordered to pay as much as $11,000.(see footnote 19) The Magic Valley Evangelical Free Church in Jerome, Idaho was ordered in 1996 to pay $5,204.(see footnote 20)

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As for eight unreported decisions, suits were commenced or formal demands made by bankruptcy trustees against churches in Washington State, North Carolina, Kentucky, Connecticut, Pennsylvania and three in Oregon. The churches settled in two, won in one, and the remaining five are being contested.

Moreover, in two cases in which churches *won* in reported decisions, they only achieved this because the court in each case contorted or ignored the plain meaning of §548 as currently worded. Bankruptcy courts in northern Georgia in 1986 and in northern Texas in 1982 both concluded that the church's spiritual services to the bankrupt parishioners constituted "value" for purposes of §548. Neither court bothered to address whether such value had been given "in exchange for" the bankrupts' charitable contributions.(see footnote 21)

In conclusion, the Free Exercise Clause of the First Amendment has been rendered anemic by the Supreme Court, and the Establishment Clause has similarly proven of no protective value for religious organizations trying to resist bankruptcy trustees who are confiscating their offerings. RFRA may be applicable to actions brought under §548, but many trustees will not agree with this and continue to make demands on churches. And RFRA may no longer be of any use against trustee actions brought under §544(b). Under the plain wording of §544 and 548(a) of the Code as currently worded, churches, synagogues and religious ministries, as well as secular charitable organizations, are almost defenseless when bankruptcy trustees demand a refund from their offering plates.

2. Our First Freedom outweighs the legitimate interest in maximizing creditor recovery in bankruptcy.

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Charitable contributions to religious organizations should be treated specially. The bill proposed by Rep. Packard is a proper "fix".

The Bankruptcy Code currently gives the debtor many generous exemptions at the expense of creditor recovery. Maximizing the size of the bankrupt estate must not be of preeminent value in the eyes of the Congress, or else the Code would not have been loaded with so many exemptions.(see footnote 22) If the rationale for these exemptions is to ensure that the debtor will have a fresh start, then certainly ensuring the proper enforcement of our First Freedom (religious liberty) should also take precedence over the interest of creditors.

The current code allows a debtor to spend all his money on gambling, liquor, luxury cruises and the like the night before he files bankruptcy, even though such dissipation leaves nothing for the creditors in the way of hard assets or revenue.(see footnote 23) Nevertheless, such expenditures are deemed "reasonably equivalent value" beyond the reach of the trustee. Certainly, the First Amendment is not less important than gambling, liquor and luxury cruises.

Moreover, the risk of loss should be on creditors, not churches or charities, as a matter of marketplace practicality and First Amendment priority. As between a good faith transferee and a good faith creditor, who ought to be left

"holding the bag" if the parishioner ends up having made charitable contributions while insolvent? The answer ought to be the party who is in the best position to investigate the creditworthiness and solvency of that bankrupt. We think the answer is clear: creditors should perform the necessary "due diligence" investigation before extending credit to or contracting with a bankrupt. Unless the religious or charitable transferee has actual or constructive notice of a debtor's fraudulent intent, the religious donee should not have their offerings confiscated years after they were given and received in good faith. As a matter of policy and First Amendment principle, creditors, not religious charities, should bear the risk of loss.

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3. The current proposed legislation strikes a proper balance and would accomplish the ''fix''.

3.1 By adding a new §548(a)(2)(A), section 3(a)(7) strikes a proper balance: a church or charity would keep what it receives in good faith from a member, even in the unlikely event that a debtor had a hidden, fraudulent intent behind his giving.

3.2 By adding a new §548(a)(2)(B), section 3(a)(7) will reverse the results in the Chapter 7 adversary proceedings discussed earlier and eliminate similar demands by trustees nationwide. The new §548(a)(2)(B)(i) would take care of virtually all of the problem cases at issue here.

3.3 The new §548(a)(2)(B) would provide a remedy in the rare case where a debtor donates more than fifteen percent. It would properly require that the debtor or charity prove that giving more than fifteen percent was consistent with the debtor's practice. Consistency of practice is certainly the best proof of the sincerity of an alleged religious belief.

3.4 Section 3(b)(2) of the proposed bill would add to §544(b) a clause that withdraws from the trustee the power to invoke state fraudulent transfer law against religious and charitable donees. This would be a significant improvement over current law. Many states' fraudulent transfer statutes allow courts to void transfers made as early as three or four years prior to the suit. For example, a most notorious case is *Scholes* v. *Lehmann*.(see footnote 24) The Seventh Circuit affirmed a federal court in ordering eleven Christian ministries (including international relief agencies) to refund $509,000 to a receiver because the transferor (unbeknownst to the charities) had embezzled the donated funds. We certainly sympathize with the devastating loss suffered by the investor victims of this embezzlement. However, as between the defrauded investors and the good faith donee ministries, we believe the former should bear the risk of loss. The investors should have investigated the bona fides of this flimflam promoter of a "too good to be true" limited partnership scheme. They did not, and they got burned. In contrast, charities were in a far poorer position to discover the shady past of the donor, let alone his embezzlement of the money. Charities should not have to ask donors for their audited financial statements or for an affidavit from their banker before accepting a gift.

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Without this amendment to 544(b), trustees can continue to do twice, three times, even six times as much damage to religious organizations and charities, because of the broader window in state fraudulent transfer laws.

3.5 Post-petition charitable contributions under a Chapter 13 plan should be protected as well, for the same reasons that support a shield for Chapter 7 pre-petition donations. A debtor's sincere religious motivation and Biblical duty to tithe does not diminish after he or she files bankruptcy. The Congress' interest in fostering religious free exercise and avoiding excessive entanglement with religion still outweighs creditors' interest in quicker repayment.

In addition, Congress must keep §3 of the proposed bill if it is going to have §4—i.e., it must fix §548 if it is going to address §1325. This is because any Chapter 13 plan must provide that the value of property to be distributed under a Chapter 13 plan on account of each unsecured claim be not less than the amount that the claimant would have received if the debtor had liquidated under Chapter 7.(see footnote 25) So, one may not sever §4 from §3 of the proposed bill.

3.6 Finally, §6, in the wake of the striking of RFRA as applied to state law, is an important (albeit indirect) affirmation of RFRA's viability and application to federal law, such as the bankruptcy code.

4. Suggested Improvements

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4.1 **H.R. 2604** CLS concurs with Professor Douglas Laycock's recommendation that additional language be added that would preempt claims in state or federal court by creditors invoking state fraudulent transfer laws. Exhibit 2 hereto exemplifies the need for such a provision.

4.2 **H.R. 2611** CLS recommends the following amendments:

a. Substitute "motivation" for "obligation". Most religions in the U.S. encourage but do not require their adherents to tithe or give donations as an act of worship and obedience.(see footnote 26) If H.R. 2611 is to benefit all religious tithers, this one-word substitution is crucial. It would also eliminate a possible challenge under the First Amendment that the bill favors religions that require donations.

b. For the reasons discussed in sections 3.4 and 4.1 *supra*, H.R. 2611 needs to protect churches against use of state law by trustees and third party creditors.

c. For the reasons set forth in section 3.5 *supra*, H.R. 2611 should extend to Chapter 13 plans.

d. CLS agrees with Rep. Chenoweth that the Congress should be able to protect religious contributions to religious organizations without such a bill violating the First Amendment's ban on an establishment of religion. However, recent decisions of the U.S. Supreme Court cast doubt on the validity of H.R. 2611, insofar as its beneficiaries are confined to religious donees. H.R. 2604 protects all charitable donees and thus would withstand such a legal challenge (and avoid political opposition from strict separationist groups).

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5. Conclusion

As presently worded, §548(a) and 544 leave churches and religious charities virtually defenseless when bankruptcy trustees seek to recover tithes and offerings. Neither the First Amendment nor RFRA provide adequate protection for church autonomy.

The proposed bill properly concludes that our First Freedom outweighs a legitimate societal interest in maximizing creditor recovery in bankruptcy. Religious freedom must be of at least as much value as gambling, and the risk of loss and duty to investigate is more properly placed upon the creditor, not a good faith religious donee. Christian Legal Society endorses H.R. 2604 ("Religious Liberty and Charitable Donation Protection Act").

On behalf of our nationwide membership of attorneys, we thank you for the opportunity to share our thoughts regarding the need for and proper wording of this important legislation.

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Mr. **GEKAS.** I thank the gentleman. Mr. Case.

STATEMENT OF STEPHEN H. CASE, ESQ., ON BEHALF OF THE NATIONAL BANKRUPTCY CONFERENCE

Mr. **CASE.** Mr. Chairman, good morning. I am grateful to appear on behalf of the National Bankruptcy Conference. We respectfully oppose the enactment of both bills, except we support one provision in one bill, which I will explain

in a minute.

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The present law carries forward, as other witnesses have said, the concepts of fairness to all creditors that have been on the books in the Anglo-American legal system since the reign of Queen Elizabeth I in 1571. These are oddly named laws. They are called fraudulent transfer laws.

If you check the Oxford English Dictionary, there is nothing fraudulent about it. Fraud was used in a broader sense in 1571 to mean anything which has the effect of leaving people tricked, just as the word trespass in the Lord's Prayer had a much broader then of any wrongdoing, rather than wrongful entry into some else's property under present law. There doesn't have to be fraud to be a fraudulent transfer. It is a linguistic oddity.

These laws permit creditors to recapture for pro rata distribution to all creditors assets transferred for inadequate value by insolvent debtors prior to bankruptcy. They have a purpose on the books.

Take a Ponzi schemer who has bilked widows out of a lot of money who is insolvent. His valuable antique collection or his beach house could be sold for a lot of money to pay the widows. To defeat their claim, he deeds the antiques or the beach house to his brother for $1. The fraudulent transfer laws that have been on the books for over 425 years are used to get that asset back to treat all creditors fairly.

The underlying policy reason for it is that when a person is insolvent, the person's money belongs to his creditors not to him, and to the insolvent person is holding creditors' assets and really has nothing of his own. To give away the money is to give away the assets of someone else.

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I am tempted to think of the Ten Commandments, but frudulent transfer has never been defined as stealing by secular lawmakers, but for the over 425 years, these laws have provided for recapture of these transfers.

There is no difference between the $1 sale of the antiques and the donation to the church. Churches are exposed to all manner of commercial risk. They have to pay for electricity and telephones just like the rest of us. Their churches unhappily can burn down and it is necessary for the congregation to buy fire insurance. Exposure to litigation for fraudulent transfer in the event of a bankruptcy of a member of the congregation is another commercial risk.

Now, let me clear the air on one issue. Mr. Chairman, except for this House at its best, no American institutions do more good every day than churches, temples, and charities. Our members across the country are leaders in local religious and charitable institutions.

I have been in the past and expect to be in the future a Presbyterian Sunday School teacher with sixth-grade kids. I like it. I am glad to do it. We oppose the legislation, but we support the works and goals of the institutions that are represented by the other panelists.

Our position, Mr. Chairman, is that Congress should not start to slice up the fraudulent transfer laws with special interest exceptions, no matter how deserving the special interest groups may be. Don't let insolvent people give away the creditors' money, we urge you.

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Now, the other witnesses have mentioned efforts in the drafting of this legislation to get around our sense of the worst case, and that is the people whose lawyers will say to the clients, look, you are filing bankruptcy, they put this charitable exception in, what do you want to do with your money or your boat or your house that you are not going to keep; do you want the trustee to get it and give it to the creditors, or do you want to give it away. It is possible lawyers

will be sued for malpractice if they don't counsel their clients to consider that.

The remedies suggested by the fine people on my left and right on the panel is inadequate. They are saying go after the creditor on an intent to hinder theory under section 540(8)(a)(1). That is a very unwise position for the Congress to take.

You will need additional bankruptcy judges, because there will be days and days of litigation to determine the state of mind of the donor. We all know from homicide and the types of cases where the state of mind of somebody is at stake, you can have endless testimony to determine did he give it away because he is a good person or did he give it away because he wanted to keep it away from his creditors. It will clog the courthouses.

There is another problem with this, Mr. Chairman. We are encouraging charitable donations with this legislation, and the federal government will bear some of the cost because charitable donations are tax deductible, and we ask whether the budget committees have scored these bills for revenue loss which may be required under the budget legislation, if I understand it.

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My time is up, Mr. Chairman. My additional points are on the last page of my statement.

[The prepared statement of Mr. Case follows:]

PREPARED STATEMENT OF STEPHEN H. CASE, ESQ., ON BEHALF OF THE NATIONAL BANKRUPTCY CONFERENCE

Good Morning. I am grateful to appear this morning on behalf of the **NATIONAL BANKRUPTCY CONFERENCE.**(see footnote 27) We respectfully oppose both bills, except we support one provision.

Present law carries forward concepts of fairness to creditors that have been on the books since 1571. These oddly-named "fraudulent-conveyance laws" permit creditors to recapture for pro rata distribution to all creditors money and other things transferred for inadequate value by insolvent debtors prior to bankruptcy. Here is a typical example: an insolvent ponzi-schemer owes hundreds of thousands of dollars to widows, bilked of their savings. The schemer's valuable antique collection can be sold for a high price to pay the victims. To defeat the victims' claim, the ponzi-schemer deeds the antiques to his brother for one dollar. The fraudulent-conveyance laws get the property back for the victims whether or not there is a bankruptcy filing.

Here is the policy reason for this: when a person is insolvent, he or she doesn't have enough to pay creditors in full. The insolvent person is holding the creditors' assets. To give them away is to give away the assets of someone else. This is why for over 425 years our legal system has provided for the recapture of these transfers.

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Like the one-dollar antique sale, religious and charitable donations produce no tangible equivalent value to the donor or the donor's creditors. Pressured to increase recoveries for creditors, trustees in bankruptcy have in recent times been applying the fraudulent-conveyance laws to recapture donations. In particular, a number of reported cases have required churches to pay back substantial donations, made as tithes, prior to bankruptcy.(see footnote 28)

Please let me clear the air on one issue. Except, perhaps, for the United States House of Representatives at its best, no American institutions do more good every day than churches, temples and charities. Accordingly, while the NBC and I oppose the legislation, we earnestly support the works and goals of the charities, schools, churches and temples.

Congress should not slice up our fraudulent transfer laws with special-interest exceptions, no matter how deserving the special interests groups may be. Don't let insolvent persons give away the creditors' money, say we at the NBC.

Here is what we consider the "worst case" under these bills: Right now many critics contend that the bankruptcy laws inadequately protect creditors. These bills will exacerbate that criticism. Each bill creates an opportunity for persons filing personal bankruptcy to stop off at the local charity(see footnote 29) and make a donation on their way to file bankruptcy. Suppose (God forbid) it was you. What would you do? You're filing bankruptcy. They are going to take your money and nonexempt property away from you. Where would you rather this property go? To the creditors? Or to the charity? What will the people filing bankruptcy do? The answer is obvious. The money will go to charity. Is this fair to creditors? We say, "No way". So will the public.(see footnote 30)

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What is more, the federal government will bear some of the cost. The charitable donations that the bills will encourage will be tax deductible. We therefore ask: have the budget committees scored these bills for revenue loss?

H.R. 2604 provides that donations are a permitted personal expense in measuring "disposable income" for purposes of confirming chapter 13 plans. The NBC supports this for chapter 13 debtors who can show an established, pre-bankruptcy pattern of donations.

If Congress decides to pass one of these bills, the NBC urges two things. First, follow the approach of H.R. 2604 and limit the exception to donations made by individuals. Second, although we haven't researched it, we wonder if the religion-only approach in H.R. 2611 in an unconstitutional establishment of religion under the Constitution. We would also appreciate the opportunity to present a few technical comments to the staff in a separate communication.

My time is up. Mr. Chairman and members of the Subcommittee, thank you.

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Mr. **GEKAS.** We will get back to you. Mr. Hardy.

STATEMENT OF RALPH W. HARDY, JR., PRESIDENT, WASHINGTON, D.C. STAKE, ON BEHALF OF THE CHURCH OF JESUS CHRIST OF LATTER-DAY SAINTS

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Mr. **HARDY.** Mr. Chairman, I am pleased to appear before you this morning on behalf of The Church of Jesus Christ of Latter-day Saints to testify in strong support of H.R. 2604.

The importance of protecting an individual Church member's right to contribute tithes and offerings is based in the most fundamental doctrines of our religion.

The Church of Jesus Christ of Latter-day Saints views the obligation to contribute one's tithing as a scriptural commandment from God. Thus, it is a core belief and practice, and a matter of deep religious conviction.

We believe that when we obtain any increase or earn income, 10% of that increase or income belongs not to us but to God to be used by our Church to further his purposes here on earth.

Our Church teaches that the voluntary contribution of a full tithing is necessary in order for a member to be in good standing. Thus, only those members who contribute a full tithe may avail themselves of the highest religious rites and ordinances of the Church, blessings which can only be obtained in our consecrated temples, such as the Washington Temple by the Capital Beltway in Kensington, Maryland.

It is only through these temple rites and ordinances and that we can unite husbands and wives, parents and children together as eternal families and be able to attain eternal salvation. This is the paramount goal of every member of our

Church.

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It is difficult to imagine a more intrusive burden on the religious conduct of a member of our church than the confiscation in bankruptcy of a member's tithing, thereby placing in possible jeopardy his or her good standing-in the Church and denying the future opportunity to obtain these singularly important blessings that can only be received in our Temples.

The Church of Church of Jesus Christ of Latter-day Saints has objected strenuously to the efforts of bankruptcy trustees across the country to seize from the Church tithes and offerings given by its members. We believe bankruptcy trustees violate the rights of our members to the free exercise of their religious beliefs as guaranteed by the First Amendment to the Constitution.

Moreover, the Church views these actions as imposing a significant burden on its rights as a religious institution to receive voluntary, good-faith donations from its membership in furtherance of the Church's worldwide mission.

Currently, our Church is forced to respond to the litigation demands of over 120 individual lawsuits brought by bankruptcy trustees in ten different states. Each of these suits seeks to seize from the Church tithing donations from Church members made privately in good faith and without any intent to hide or divert wealth. These modest contributions come from members who have then subsequently experienced financial difficulties and have filed a personal bankruptcy after the donations were made.

The trustee suits typically seek to seize all donations made during the 4 years immediately preceding the bankruptcy filing. In each such case, the Church is barraged with subpoenas or requests for production of documents as well as interrogatories from the attorney for the bankruptcy trustee, seeking private donation records, confidential information kept by the Church. These subpoenas and requests for production necessitate in each case research by Church employees at general Church headquarters in Salt Lake City, Utah, as well as research into local congregational financial records by members of the Church's lay ministry at the local level.

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The Church of Jesus Christ of Latter-day Saints has incurred and continues to incur significant legal expenses in retaining counsel in Salt Lake City, Utah as well as in those states where these lawsuits are being litigated. In defending against the demands of bankruptcy trustees, The Church of Jesus Christ of Latter-day Saints is interested primarily in asserting the rights of its members who made the contributions in question. These members are clearly ill-equipped to mount an effective challenge to this significant impairment of their religious beliefs.

The Church of Jesus Christ of Latter-day Saints and its approximately 5,000,000 members in the United States joins the other denominations represented at today's hearing in urging this Committee to approve H.R. 2604, thereby providing a needed prohibition to a bankruptcy trustee's powers to confiscate voluntary, good-faith donations offered in compliance with Church doctrine and in obedience to God's law. Thank you.

[The prepared statement of Mr. Hardy follows:]

PREPARED STATEMENT OF RALPH W. HARDY, JR., PRESIDENT, WASHINGTON D.C. STAKE, ON BEHALF OF THE CHURCH OF JESUS CHRIST OF LATTER-DAY SAINTS

Good morning. My name is Ralph W. Hardy, Jr. I am the lay president of the Washington DC Stake (diocese) of The Church of Jesus Christ of Latter-day Saints. I am pleased to appear before this committee in support of H.R. 2604.

At the outset, I will speak to some of the most fundamental beliefs and practices common to all members of The Church of Jesus Christ of Latter-day Saints. This is, to us, first, obedience to the Lord's ancient and modern scriptural

injunctions to contribute to the Church our tithes and offerings, no matter what our financial circumstances may be. Second is our right, as worthy members of the Church, to receive the highest rites and ordinances of our religion in the temples of the Church, which blessings to us are conditioned upon our having been obedient to all the Lord's commandments, including the ancient law of tithing.

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I. DOCTRINAL PERSPECTIVE

The practice of tithing is deeply entrenched in America's religious traditions. First mentioned in the Pentateuch, *see* Lev. 27:30–32, tithing constitutes an important part of religious devotion in the United States and throughout the world. Indeed, many religious organizations, including The Church of Jesus Christ of Latter-day Saints (the "Church"), view tithing as a commandment from God:

"For I am the Lord . . . . Bring ye all the tithes into the storehouse . . . and prove me now herewith saith the Lord of hosts if I will not open you the windows of heaven, and pour you out a blessing, that there shall not be room enough to receive it." (Malachi 3:6, 10)

"Verily, thus saith the Lord, I require . . . the tithing of my people. . . . one tenth of all their interest annually; and this shall be a standing law unto them forever . . ." (Doctrine and Covenants of The Church of Jesus Christ of Latter-day Saints [hereinafter cited as "Doctrine & Covenants"] 119: 1, 3–4)

Members of The Church of Jesus Christ of Latter-day Saints believe in and practice the law of tithing as a fundamental precept and doctrine. We believe that tithing is a divine commandment from God, which was established by God anciently on this earth (see Malachi 3:8–10) and continues in force today (see Doctrine & Covenants 119:1–4). We believe that when we earn income, ten percent of that income, whether in specie or in kind, belongs to God, to be used by our Church to further God's purposes here on earth, and that those monies do not belong to us. We believe that if we fail to pay our ten percent tithe to God, we are, in reality, robbing God (see Malachi 3:8–9). We obey the law of tithing as a matter of our deep, personal religious convictions and in the sincere, good faith exercise of our personal religious beliefs.

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We have been taught and believe that the voluntary contribution of a full tithing—with the money or other in-kind contribution being used by the Church to further God's work on earth through the worldwide religious activities and mission of The Church of Jesus Christ of Latter-day Saints—is necessary in order for a member to be in good standing in our Church. We believe devoutly that our living of and obedience to the Lord's law of tithing is a crucial component to our spiritual development on earth and to our eternal salvation. Indeed, only those members of The Church of Jesus Christ of Latter-day Saints who contribute a full tithe may take upon themselves the highest religious ordinances and rites in the sacred temples of the Church such as the Washington Temple in Kensington, Maryland. As members of The Church of Jesus Christ of Latter-day Saints, we believe that it is only through these highest ordinances and rites that we can attain eternal salvation and live together with our family throughout eternity. Thus, in our minds, there could be fewer, more substantial burdens on our religious beliefs and on our constitutional rights as members of The Church of Jesus Christ of Latter-day Saints than for a third party to seize our tithing or other sacred voluntary offerings made to the Church, thereby putting us, the members of the Church, in a position of having robbed God, and having not met what we believe is a divine commandment from God.

The Church of Jesus Christ of Latter-day Saints objects strenuously to the present efforts of bankruptcy trustees across the nation to sue the Church, as well as other churches which receive donations from their members, and to attempt to seize any part of tithing or other donations from The Church of Jesus Christ of Latter-day Saints as well as from other churches. The Church of Jesus Christ of Latter- day Saints feels such actions by the bankruptcy trustee violate the constitutional rights of Church members to exercise their religious beliefs in accordance with the dictates of their own conscience as well as the religious doctrines and teachings of the Church itself. Moreover, it is the position

of The Church of Jesus Christ of Latter-day Saints that the trustees' actions burden the Church's rights to receive voluntary, good faith donations from its members which are used, in turn, in furtherance of the Church's worldwide charitable and religious activities.

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Most members of The Church of Jesus Christ of Latter-day Saints who find themselves in the position of having to file a personal bankruptcy are not aware that filing their bankruptcy petition would give rise to a possible lawsuit by the bankruptcy trustee in their case against the Church itself to seize the member's sacred, good faith religious donations—donations made by the members in the strictest of confidence to their Bishops. Our members feel that the trustees' actions put them in a very real and terribly difficult conflict by unfairly requiring them to choose between their religious beliefs concerning the importance and sanctity of their personal tithing donations, and their right to financially rehabilitate themselves through filing a bankruptcy petition, thereby subjecting their Church to a lawsuit by a bankruptcy trustee to seize tithing donations made by the members.

II. ADMINISTRATIVE BURDEN

Currently, The Church of Jesus Christ of Latter-day Saints is having to respond to the litigation demands of over 120 individual lawsuits brought by bankruptcy trustees in ten different states across the country against the Church itself. Each of these suits seeks to seize religious donations made in good faith (which is acknowledged and admitted in every single case) by Church members, who have subsequently experienced financial difficulties, and have filed for personal bankruptcy. These lawsuits against The Church of Jesus Christ of Latter-day Saints typically seek to seize all donations made during the four years immediately preceding the bankruptcy filing. In each such case, the Church is faced with subpoenas, or requests for production of documents, as well as interrogatories, from the attorney for the bankruptcy trustee, seeking confidential donation records and information kept by the Church. These subpoenas or requests for production necessitate, in each case, research by Church employees at the general Church headquarters in Salt Lake City, Utah, as well as research into local ward (parish) financial records by members of the Church's lay ministry at the local level.

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The Church of Jesus Christ of Latter-day Saints has incurred and continues to incur significant legal expenses in retaining counsel, both in Salt Lake City, Utah, as well as local counsel in the states where the lawsuits are being litigated, to represent the interests of the Church in defending the growing number of avoidance actions.

In defending demands of bankruptcy trustees, The Church of Jesus Christ of Latter-day Saints is primarily interested in asserting the rights of its members who made the contributions in questions. These members—who typically have contributed relatively modest amounts but have subsequently fallen on hard times financially—are clearly ill equipped to mount an effective challenge to the impairment of their most fundamental religious beliefs that the trustees demands present.

III. LEGAL ISSUES

Tithes are a form of religious devotion and worship in The Church of Jesus Christ of Latter-day Saints, with the tithes belonging to God for use in the building of His Kingdom:

"I, the Lord, stretched out the heavens, and built the earth, my very handiwork; and all things therein are mine. And it is my purpose to provide for my saints, for all things are mine. But it must needs be done in mine own way . . . For the earth is full, and there is enough and to spare . . ." (Doctrine & Covenants 104:14–17)

Few forms of government action burden religious practice more severely than government sponsored interference with the time-honored form of worship. Applying 11 U.S.C. §548(a) or its state law counterpart, utilized by a bankruptcy trustee through 11 U.S.C. 544 of the Bankruptcy Code, to repossess these tithes effectively nullifies this religious act.

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To obscure the extent of this damage to religious observance, some parties have suggested that applying §548(a) and §544 in this context would not burden individual debtors' exercise of religion because, even if the government retroactively nullifies their tithes, the debtors are certainly able to attend church services, participate in church programs, and worship and believe as they so choose, regardless of the trustee's seizure of the donation. This argument is untenable on its face: it suggests that suppressing *one* form of religious devotion does not "burden" religious observance if an individual may still engage in *other* forms of devotion. If, for example, the government prohibited the taking of communion, that prohibition would burden the free exercise of religion whether or not the state still permitted the singing of hymns. Likewise, if the government imposed regulatory prohibitions on sacramental wine, that imposition would infringe upon religion regardless of whether the state still permitted prayer in church meetings. Having taken away a legitimate, fundamental and sacred form of worship, the government may not excuse its action by pointing to alternate forms of worship and devotion which are still permissible under the government scheme.

Moreover, quite apart from the burden on religious individuals, enforcing §548 and §544 in this context would seriously threaten any religious *organization*—of which The Church of Jesus Christ of Latter-day Saints is simply one example—whose very existence depends upon the unfettered, voluntary contributions from its membership. Church doctrine provides that, at the very moment an individual member receives any type of increase, one-tenth of that increase, in fact, belong to God.

The bankruptcy law strikes a balance between the interests of creditors and the interests of debtors. For example, upon declaring bankruptcy, a debtor is entitled to retain many of the material goods in his or her possession even though such assets could obviously be sold for the benefit of this creditors. *See* 11 U.S.C. §522 *et seq.* Such provisions illustrate that the bankruptcy laws themselves do not treat the government's interest in maximizing a creditor's recovery as sufficiently compelling to outweigh certain of the debtor's material interests. By the same token, a debtor's right to receive a financial "fresh start" is thoroughly qualified and conditioned upon the rights of creditors to prove that their debt(s) fall within statutory categories pursuant to which the debtor is denied a discharge under the Bankruptcy Code, thereby elevating the creditor's right to repayment over the "fresh start" policies of the bankruptcy system (*see* 11 U.S.C. §523). In certain instances, the nature of the debtor's conduct is such that the debtor may be denied a discharge from the entirety of his debts (see 11 U.S.C. §727). Therefore, one cannot plausibly contend that the same governmental interests are sufficiently "compelling" to outweigh a debtor's most basic religious interest in preserving the products of his devotion. *See Quaring* v. *Peterson*, 728 F.2d 1121 (8th Cir. 1984) (holding that the State of Nebraska could not claim a compelling governmental interest in requiring photographs on drivers licenses because the state had statutorily recognized numerous exemptions in which a photograph was not required), *aff'd,* 472 U.S. 478 (1985).

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The Church of Jesus Christ of Latter-day Saints and its approximate 5 million members in the United States joins the other denominations represented at today's hearing in urging this Committee to approve H.R. 2604, thereby providing a needed exemption to a bankruptcy trustee's avoidance powers to protect voluntary, good faith donations made to any qualifying charitable organization.

Mr. **GEKAS.** We thank the gentleman. The chair will yield itself for 5 minutes for the purpose of questioning.

Mr. Case, you state in your written statement that you believe that the Chenoweth bill is unconstitutional, is that correct?

Mr. **CASE.** We say that while we haven't researched it, it raises the question of whether it is an establishment of religion and while our organization does not purport to be constitutional scholars, if the Chairman would prefer, we will take a look at it and offer you our views.

I am not here to say——

Mr. **GEKAS.** In that regard, Professor Laycock, how do you view the constitutionality or lack thereof of the Chenoweth bill?

Mr. **LAYCOCK.** I think the Chenoweth bill is constitutional, but I am not confident that is what the courts will ultimately decide. The trustees around the country are vigorously challenging the claim that RFRA can constitutionally protect tithes to churches without protecting gifts to secular organizations, and courts are taking that Establishment Clause issue very seriously.

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Mr. **GEKAS.** If Mr. Case would like to submit a memorandum to us on that issue, we would welcome it.

Mr. **CASE.** Recognizing that we practice bankruptcy law and not constitutional law, we will do our best, Mr. Chairman.

Mr. **GEKAS.** We have to have more areas than just one in our bag.

Mr. Case, when a charitable contribution is made and a tax credit is gained thereby, you believe, of course, that that means less revenue for the federal government, and it is true. But if someone makes a charitable contribution and then goes bankrupt, where do the tax consequences come in if indeed there is nothing left, no income taxes filed, no income tax return is filed or if one is filed, there is no tax in it anyway. Is that just a de minimus concern of yours?

Mr. **CASE.** No, Mr. Chairman. Our suggestion is this, that if the legislation is passed and if as a consequence of the legislation passing it increases charitable donations which are exempt from recapture under the fraudulent transfer laws, then just picking an illustration, a 25-percent tax rate, every 25 percent, 25 cents out of every one of those extra charitable dollars will essentially be contributed by the United States Treasury.

Mr. **GEKAS.** Yes, but that presupposes that they didn't go bankrupt.

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Mr. **CASE.** If I am going bankrupt and I contributed an extra $100 to my church, I get a tax deduction on my tax return for the pre-petition period for that $100, and the estate is not going to get it back. It is going to stay and it is going to be an effective, valid, irreversible donation, and it will cost the Government some tax revenue.

Mr. **GEKAS.** Mr. McFarland, you mentioned that the question in the Chenoweth bill that "obligation" should be changed to "motivation." There is no problem with the definitions in H.R. 2604, is there?

Mr. **MCFARLAND.** No, sir.

Mr. **GEKAS.** Would adoption by the Chenoweth bill of the definitions in H.R. 2604 solve the problem?

Mr. **MCFARLAND.** That would solve that problem, yes, but H.R. 2611 still falls short with respect to the state fraudulent transfer laws, the possible Establishment Clause problem, and its failure to address Chapter XIII.

Mr. **GEKAS.** I have no further questions in this first round. If any pop into my mind, I will reserve a second round.

Now, we yield to the gentleman from Massachusetts.

Mr. **MEEHAN.** Thank you, Mr. Chairman. I would like to throw a couple questions out to any of the members of the panel who would be interested in giving an opinion.

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In terms of an individual debtor's contributions to his or her house of worship that have been voided by a bankruptcy trustee under section 548 of the Bankruptcy Code, how much money are we talking about? Are we talking about large sums of money or are we talking about instead smaller amounts of money? What data is out there in terms of the individual contributions and the overall amount of contributions that we are talking about that have been affected?

Mr. **CASE.** Could I respond briefly? I am here for the National Bankruptcy Conference, but during another life, I was an advisor to the National Bankruptcy Review Commission, and I assisted Commissioner Gose in his work on data, and there is data language in the excellent bill with Congressman Gekas has introduced.

The point I want to make is that there is no data such as you are asking for, and there is a dramatic need for bankruptcy legislation to capture and report more data so that policy-makers like you can address problems like this on a much better informed basis.

Mr. **HARDY.** I am advised by the headquarters of the Church of Jesus Christ of Latter-day Saints that of the 120 cases that I indicated in my testimony that we are involved with, that the amounts are very, very modest.

Mr. **LAYCOCK.** I think it is true that there is no data. What we have is basically anecdotal evidence from the filed cases, and also, you can think this through a little bit.

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It is not unusual to put $20 a week in the collection plate; that is not a large contribution. The statute of limitations is 4 years, and $20 a week is a $4,000 fraudulent transfer claim if it goes back the full period of the statute of limitations.

What is also relevant here is that this law isn't settled yet. The first case is still on appeal. When the law becomes settled, I think contributions become just a checklist item, and any amount will be worth going after, no matter how small it is.

In some of the cases where you have debtors with a substantial income and a business failure caused the bankruptcy and they were tithing, the amounts may be very much larger.

In the *Cedar Bayou* case, that debtor had tithed for 43 years. He had an annual income of about $60,000. He was giving $6,000 to the church. He went bankrupt through a bizarre set of circumstances. A partnership dissolved, the managing partner distributed the profits of $30,000 each. Three years later, he said we made a mistake, that there weren't any profits, and I want the $30,000 back. Not only that, it is joint and several liability, and you are responsible for the $30,000 I gave to each of the other partners. It wound up being a judgment of $150,000 against this guy who otherwise never had any financial trouble in his life.

The judgment against the church covers $23,000 in contributions made from 1988 to 1992, plus $22,000 in interest that has accrued thus far, so it is a judgment of $45,000 at this point.

The amounts can vary from very small to very large, but if the law becomes settled, there will be a vast number of these claims and the cumulative amount will be large.

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Mr. **GOOLD.** In terms of specific amounts, there are studies that have been done. George Gallup did one a year ago, and George Barna, a respected researcher within the church community in America, that indicated very clearly that the average giving to the church, on the high side, is four percent. That is the Assembly of God, and on the low side, it goes down to half of one percent, and I won't name that group. But to answer, quite specifically, we would on the average be dealing with people who would be giving somewhere between two to three percent.

Mr. **MEEHAN.** Let me ask you, getting back, Chairman Gekas had talked about this motivated by a sense of obligation, language that is in H.R. 2611. What is the justification for exempting from section 548 only those contributions to religious entities that are motivated by a sense of obligation as opposed to gifts that are inspired by simple respect or support for the mission of a church or a synagogue? Aren't both types of contribution equally meaningful exercises of religious belief?

Mr. **GOOLD.** Yes, I agree completely. I believe the distinction is an erroneous one.

There is a great deal of theological basis for what is called an "offering." That is over and above a tithe, and the offerings were typically given to other churches, other locations geographically in the New Testament, and many, many believers have within themselves a sense that when they are giving to God, they are giving not only to their local church but to the work of God in many legitimate ways through organizations outside the church in the spirit of benevolence and good will. So I think the distinction is erroneous.

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Mr. **GEKAS.** Mr. McFarland, do you have an opinion on that?

Mr. **MCFARLAND.** Yes, I certainly agree that both should be covered. I can't see a logical scriptural or constitutional distinction between what is motivated versus compelled present, H.R. 2611 would only protect members of the Church of Jesus Christ of Latter-day Saints, some Jewish groups, and the vast bulk of Protestant and Catholic Christianity would not be covered.

May I just address the earlier question? I do have statistics. This is for the state of Utah, and the latest figures show that people in the state of Utah give $4,600 on average compared with Rhode Islanders who give the least at $1,547 on average. The national average, however, and these are gifts to any charity, is $2,500, and I might add that once the first breach in the dam, namely the *Crystal* case, occurred, then it becomes a fiduciary duty of trustees to exhaust every possible avenue, every possible argument, and indeed, they get paid by the hour to do so.

Not only would they forego some attorney's fees or trustee's fees, but they would also potentially incur liability for failing to sue a church and charity as soon as they see it show up on the Chapter 7 petition.

Mr. **MEEHAN.** Thank you.

Mr. **GEKAS.** I thank the gentleman. I only have one other question, and that is to Doctor Goold.

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The issue of value returned by religious services, weddings, funerals, all the other things that a good church provides in services, did that question ever come up in your case?

Mr. **GOOLD.** Yes, it did, and what the court determined was that since there was no literal exchange of temporal items that you could see, touch, or feel, therefore, in the strict application of the Bankruptcy Code as it exists now, that there was no value in return.

We, of course, believe that which is of greatest value is the human spirit and the soul. And ministry to the entity that cannot be seen is now being made to be of no value through this kind of misapplication of current bankruptcy law. That is unacceptable in our society.

Mr. **LAYCOCK.** Mr. Chairman, could I speak to that question?

Mr. **GEKAS.** Yes.

Mr. **LAYCOCK.** I think there are two versions of what trustees in bankruptcy courts are saying. Some of the early cases said there is simply no value here; everything the church provides is intangible, and that doesn't count.

The more sophisticated opinions are saying that there is value. The religious services have value; counseling has value; having a place to worship in, a building, is value; but that value is not given "in exchange for" the contribution, because even if you don't contribute, the church won't kick you out. If they would just be more hard-nosed like a commercial business and kick you out when you didn't contribute enough, then this would be an exchange, and then they would be able to keep it. But because they practice evangelism and reach out to people who aren't committed to giving yet, and because they practice charity and reach other people who can't give, they are not in a position to kick people out, so they cannot satisfy the in-exchange-for requirement.

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Much of this problem arises from taking a commercial norm and applying it woodenly to a noncommercial religious context.

Mr. **GEKAS.** I think mine would kick me out. We thank the panel for its thorough presentation of the various views, and we dismiss them with the gratitude of the subcommittee.

One other factor, the gentleman from New York, Mr. Nadler, who is the ranking Democrat member of the subcommittee, has asked for unanimous consent, which without objection we grant, to submit questions for the record, which questions where pertinent would be transmitted to you. Your volunteering to respond would be very helpful and would expand the record in this case.

We thank you very much and the committee is dismissed and the hearing is adjourned. Thank you very much.

[Whereupon, at 11:45 a.m., the subcommittee adjourned.]

A P P E N D I X

Material Submitted for the Hearing

QUESTIONS FOR THE RECORD SUBMITTED BY MR. NADLER FOR RALPH W. HARDY, JR., ESQ., PRESIDENT, WASHINGTON D.C. STAKE, THE CHURCH OF JESUS CHRIST OF LATTER–DAY SAINTS

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Q: Section 3(a) of the Packard bill provides a safe harbor for donations of 15% of gross annual income in the absence of a prior pattern of giving. The Subcommittee has been informed that the 15% level is necessary to ensure the protection of the tithing practices of the Church of Jesus Christ of Latter-day Saints. In your testimony, at page 2, citing Leviticus, Malachi, and the Doctrine and Covenants of the Church of Jesus Christ of Latter-day Saints, you state that church members ''believe that when we earn income, ten percent of that income, whether in specie or in kind, belongs to G-d.'' In order to ensure that the Subcommittee has an appropriate understanding of the religious practices to be protected by this legislation, could you clarify whether a safe harbor in excess of 10% of gross annual income would be necessary to ensure that members of your church are adequately protected?

A: Faithful members of The Church of Jesus Christ of Latter-day Saints pay their "tithes and offerings." The principle of paying both "tithes" and "offerings" is mentioned in many places in the Old Testament:

Will a man rob God? Yet ye have robbed me. But ye say, Wherein have we robbed thee? In tithes and offerings. (Malachi 3:7–8)

As practiced in The Church of Jesus Christ of Latter-day Saints, tithing is ten percent of one's "interest" or income annually. In addition, members also obey the scriptural admonition to pay, over and above tithing, their other "offerings" to The Church of Jesus Christ of Latter-day Saints. Such "offerings" would include, for example, (1) contributions throughout the year of "fast offerings" for use by local ecclesiastical authorities in caring for the poor and those in need; (2) contributions into the missionary fund of the Church for support of missionaries and missions throughout the world; and (3) contributions for humanitarian assistance administered by the Church.

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Thus, the cumulative effect throughout a given year of the payment by a member of The Church of Jesus Christ of Latter-day Saints of "tithes" plus other "offerings" would well exceed ten percent of the gross annual income for that member. Accordingly, The Church of Jesus Christ of Latter-day Saints supports the language in H.R. 2604 providing for the protection of fifteen percent safe harbor.

Finally, we note that, in addition to payment annually of "tithes and offerings" to The Church of Jesus Christ of Latter-day Saints, a member may also make additional contributions to other qualified charitable entities or organizations, such as the Boy Scouts of America and educational institutions.

QUESTIONS FOR THE RECORD SUBMITTED BY MR. NADLER FOR STEPHEN H. CASE, ESQ., REPRESENTING THE NATIONAL BANKRUPTCY CONFERENCE

Q 1: Some have compared a donation from an insolvent debtor to a charity which can be avoided on the one hand and a contribution to an exempt retirement plan on the other. Similarly, supporters of both bills argue that if prepetition expenditures on entertainment or gambling are permitted, than so should religious or other charitable contributions. What would be the policy basis for these distinctions in the current Code?

A: At first blush it might seem irrational to protect from avoidability a debtor's payments for carousing and gambling but to expose to avoidability important gifts to needy houses of worship and charities. However, there are important reasons for the distinction.

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Respecting (and keeping the courts from second guessing) arms-length trades in which each party gives something of value to the other is an essential feature of a market economy.

There is no "reasonably equivalent value" returned to the debtor for religious contributions. Witnesses for religious groups at the February 12 hearing conceded (as one would expect) that the churches and temples will provide their benevolent services to all in need, regardless of whether they contribute. Accordingly, so the witnesses conceded, no "value" is purchased by a donation to a church.

As to contributions to retirement plans, it is obvious that the contributor receives "value" in exchange, i.e., the right to future retirement payments.

As to prepetition expenditures on entertainment and gambling, one can conclude that the debtor receives "value" in the form of relaxation or excitement. These types of items are distinguishable from the benevolence of a religious institution because the purveyors of entertainment and gambling do not normally give them away.

While Congress could attempt to exclude gambling and entertainment from protection under the fraudulent-transfer laws, the NBC would recommend against it. The NBC favors keeping bankruptcy laws as even-handed and simple as possible.

Also, there are other remedies in the Bankruptcy Code for debtors who abuse its protections. First, under Section 523(a)(2)(C), there is no discharge in chapter 7 for consumer debts incurred or cash advances for the purchase of luxury goods and services within 60 days' prior to bankruptcy. Second, under Section 707(b) the court may dismiss the chapter 7 case of an individual if it finds that granting relief (i.e., a discharge) would be a "substantial abuse" of chapter 7.

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Q 2: If Congress intends to allow for charitable giving prepetition, and within an individual's plan of reorganization, what changes to the proposed legislation before the Subcommittee would you recommend to ensure that this change is not abused?

A: While remaining opposed to any change in the statute, the NBC would suggest, in response to the question, that charitable contributions be protected against avoidance only if made in cash, only if given by individuals and then only to the extent they did not exceed the debtor's pattern of giving for a reasonable pre-petition measuring period. We would suggest that the period be five years.

Q 3: Some have suggested that 11 U.S.C. 548(a)(1) would provide adequate protection against fraudulent transfers under the guise of religious or other charitable giving. What is the standard for proving a fraudulent transfer under (a)(1) and why would it not be adequate to protect against misuse of the proposed legislation?

A: Our responses on this question are these:

First, Section 548(a)(1) is confined to "actual" fraud, the thrust of which is revealed in the concept of good, old-fashioned, five-fingered common-law fraud that law graduates remember from law school: (i) misrepresentation (ii) of a material fact (iii) with intent to deceive which is (iv) reasonably relied on (v) to the damage of the entity defrauded. The concepts of fraudulent transfer are aimed at a much broader concept of a level playing field in bankruptcy, i.e., undoing unfair advantages received by persons who, through "undervalue" transactions received more before the bankruptcy case was filed than they would, after. To confine the avoidance remedy for charitable giving to Section 548(1)(1), therefore, would be much too narrow to effectuate the broader objectives of the statute.

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In other words, a transfer can implicate the principles of fraudulent transfer law even when the debtor's intentions were completely honorable. Section 548 embodies the idea that, while U.S. policy does not interfere with a debtor's ability to make exchanges for value, we do insist that he or she stop giving things away. A debtor can be as well intentioned as one pleases, but someone who is insolvent has no business giving away someone else's money.

Second, Section 548(a)(1) doesn't work for another reason: it calls for agonizingly uncertain, expensive and inconclusive litigation about the state of mind of the debtor at the time of the transfer. In more particularity, here is our thinking.

Section 548(a)(1) allows avoidance of transfers made with *actual intent* [emphasis supplied] to hinder, defraud or delay creditors. According to the leading treatise, Section 548(a)(1) "requires an actual fraudulent intent."(see footnote 31) This "requires [on the part of the transferor] a purposeful act intended specifically to defraud creditors . . ."(see footnote 32) and, on the part of the court, a "subjective inquiry into the transferor's state of mind at the time the transfer was made."(see footnote 33)

It is the latter, the "subjective inquiry" by the court that we think makes the 548(a)(1) "solution" to the issue presented most unpalatable. Imagine this hypothetical example: debtor, shortly before filing bankruptcy, has "coincidentally" sold all his nonexempt property and donated 80% of the proceeds to an established church. Prior to this act, the debtor has never, he testifies, done more than put $20 in the collection plate at church services for Christmas and Easter. The debtor is on the witness stand.

His lawyer says: 'Mr. Debtor, what was your intent in giving this money to the church?'

Answer: "Well, I haven't been feeling well lately, you know, stress of bankruptcy and, um, well, when I was a kid the family was always going to church and, you know, since then, um, I've, well sort of drifted away and lately I just began to feel well, that I ought to get back in touch with, in the good graces, you know with the church, so I decided now was to the time to do it in, you know a major, a meaningful way with this gift. It has been on my mind for, oh, maybe, the last 12 years, that I ought to do this.'

Question: 'Mr. Debtor, did it enter your mind or was it in any way in your mind at the time you made this gift that it might hinder, defraud or delay your creditors if you made this gift?'

Answer: 'Mr. Lawyer, heavens no. I didn't think about that at all. It never occurred to me.'

To the court: 'Your Honor, we rest.'

Now, the cross-examination by the trustee will probably set out to undermine that testimony and crack the credibility of the witness. It may or may not succeed in that objective.

The point is that conducting inquiries into the state of mind of an individual is an expensive, complex matter, very time consuming for the trial courts. The leading treatise cites a venerable Second Circuit case which makes the point well:

"The elements productive of [the] intent [to hinder, defraud or delay] . . . can never be defined. They vary as do facts, and any judge or jury, dealing with facts by some rule of thumb, will always miss the human touch. Testimony can never be tested or weighed by machined."(see footnote 34)

Q 4: If Congress allows charitable giving in chapter 13, should the legislation be extended to individual debtors in chapters 11 and 12?

A: As to chapter 11: probably not needed.

As to chapter 12, yes, for the same reason as it is appropriate in chapter 13.

Chapters 12 and 13, using virtually identical wording, require the debtor, during a three-to-five year period of supervision, to remit to the chapter trustee all "disposable income."(see footnote 35) The NBC believes that disposable income should be net of reasonable charitable giving, if consistent with a debtor's pre-bankruptcy pattern of giving. This is explained in the context of chapter 13 in our presentation at the hearing. The logic applies as much to chapter 12, in as much as in this particular the wording of the statutes is virtually identical.

This implements, in other words, the concept that the debtor should be able to use income during the period of supervision under the plan to 'live a normal life' and give the excess income to the creditors. If a 'normal life' pre-filing was to give to charity, then the same should be true after the filing.

As to chapter 11, it is used by individuals, but not all that commonly. In chapter 11, normally, once the debtor confirms a plan he or she would be free of continuing court supervision. There is no definition of "disposable income" in chapter 11. Accordingly, we do not think chapter 11 needs to be amended to make it clear that the post-chapter 11 debtor may lawfully make charitable contributions. This is best left to the plan-formulation and negotiation process. If,

in future years, the courts hold that chapter 11 plans are not confirmable because of the debtor's proposed post-case pattern of giving, Congress can act. We do not believe action is necessary now.

QUESTIONS FOR THE RECORD SUBMITTED BY MR. NADLER FOR PROFESSOR DOUGLAS LAYCOCK, UNIVERSITY OF TEXAS LAW SCHOOL

Q 1: As drafted, both bills protect the right of the debtor to make contributions under certain circumstances. Does the religious institution have a free exercise right to retain a debtor's tithe, and if so, what would be the basis of that right? If such a right exists, or should be recognized, what limits, if any, should be placed on the religious institution's right to keep a tithe?

A: Bankruptcy courts have generally not recognized the religious institution's free exercise right to "keep a tithe." I think that these decisions are erroneous; they reflect a narrow reading of *Employment Division* v. *Smith,* 494 U. S. 872 (1990), and a hostile reading of the Religious Freedom Restoration Act, 42 U.S.C. §2000bb et seq. (1994). *In re Young,* 82 F.3d 1407 (8th Cir. 1996), vacated as *Christians* v. *Crystal Evangelical Free Church,* 117 S.Ct. 2502 (1997), did not reach the free exercise issue, and did not consider the rights of the religious institution; it found a RFRA violation because of the substantial burden on the religious exercise of the debtor/contributor.

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In my judgment, these fraudulent transfer suits against churches also violate the free exercise and RFRA rights of the churches. The true question is not whether the church may "keep a tithe" or must refund the tithe. In nearly all these cases, the tithe has long since been spent on the work of the church. The question is whether the church must divert current contributions from the religious mission for which they were given, and instead use those funds to help pay the secular creditors of one of its members. This coerced diversion of resources from religious to secular ends imposes a substantial burden on the churches' exercise of religion, thus triggering the compelling interest under RFRA.

Whether this burden also triggers the compelling interest test under the Free Exercise Clause depends on disputed interpretations of *Employment Division* v. *Smith* and *Church of the Lukumi Babalu Aye, Inc.* v. *City of Hialeah,* 508 U.S. 520 (1993). The Justice Department has argued in *In re Young* that 11 U.S.C. §548(a)(2) (1994) is a neutral and generally applicable law, because it was enacted without religious motive, and because it applies to all transfers not in exchange for reasonably equivalent value. In effect, this is the circular argument that every law is generally applicable to whatever it applies to.

I think that Smith and Lukumi mean more than that. Properly interpreted, *Smith* and *LuLumi* do not establish a motive test. The motive part of Justice Kennedy's opinion in Lukumi got only two votes. Nor is the inquiry under *Smith* and *LuLumi* confined to the single statutory section that is challenged. The Court in *Lulumi* looked to the whole body of Florida and Hialeah law on animals and garbage disposal. Because Hialeah failed to regulate secular conduct that caused harms similar to the harms of animal sacrifice, the ban on sacrifice was not a neutral and generally applicable law.

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If I am right in my reading of *Smith* and *Lulumi,* then the application of §548(a)(2) to ordinary course contributions to churches is a violation of the Free Exercise Clause. Consumers are free to dissipate their money in almost every imaginable way prior to the filing of bankruptcy. They can spend it on high living; they can gamble it away; they can invest it in exempt retirement funds and their exempt homestead. Nearly everything a consumer does deprives his creditors of value. None of those ordinary course transactions are avoidable except for contributions to charity.

The debtor receives value from his church, but the lower courts say that this value is not "in exchange for" the debtor's contributions. This wooden interpretation of "in exchange for" plays the same role here as the requirement of

"ritual or ceremony" did in *Lulumi: it* distinguishes the exercise of religion from nearly all similar secular conduct. It mistakenly puts the tithe in the narrow disadvantaged category of §548(a)(2), instead of in the broad general rules of the Bankruptcy Code. I therefore believe that these cases violate the Free Exercise Clause. But obviously, the Bankruptcy Courts are ruling the other way.

Outside the bankruptcy context, the lower court cases are badly mixed. Some read *Smith* and *Lukumi* the government's way; some read it my way. In my judgment, the two best opinions are *Rader* v. *Johnston*, 924 F. Supp. 1540 (D. Neb. 1996), and *Keeler* v. *City of Cumberland*, 940 F.Supp. 879 (D. Md. 1996).

I believe that this free exercise right can be limited to cases of constructive fraud. Cases of actual fraud are rare, and may be divided into two categories. First, if the church knows of the actual fraud at the time it receives the contribution, the church itself is seeking to profit from illegal conduct. No one claims that that is a part of the free exercise of religion.

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The harder cases are those where the donor has the actual intent to defraud his creditors, or where the gift is the proceeds of actual fraud, but the church is unaware of the fraud. When the fraud is discovered and the church is sued, the impact in the individual case is the same as in the constructive fraud cases: the church must divert current contributions to pay the judgment, even though the church is innocent. But the cumulative burden is much smaller, because there are so few of these cases. Cases under §548(a)(2) are routine; actual fraud cases are rare.

Furthermore, the government may plausibly assert a compelling interest in pursuing the proceeds of actual fraud. It cannot assert a compelling interest in increasing recovery for creditors under §548(a)(2), because it makes no effort to generally pursue the goal of maximizing recovery for creditors.

Q 2: The Supreme Court's decision in *Boerne struck down the Religious Freedom Restoration Act as applied to state law. Is RFRA still good law as applied to federal law, such as Title 11?*

A: Yes. The Supreme Court's opinion in *Boerne* deals exclusively with Congressional power to enforce the *Fourteenth Amendment, which was the only power relied on to support RFRA as applied to state and local government. Boerne* says nothing and implies nothing about the validity of RFRA as applied to federal law. As to that question, the reasoning of *EEOC* v. *Catholic University*, 83 F.3d 455, 469–70 (D.C. Cir. 1996), is unanswerable: Congress has plenary power to determine the reach of federal statutes, which it enacted in the first place.

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Having said that, I must note that several federal courts have mindlessly applied *Boerne* to invalidate RFRA as applied to federal law, without briefing and without apparent thought. The issue is fully briefed and under submission to the Eighth Circuit in *In re Young.*

Q 3: In your testimony, at page 9, you discuss the Code's ''ordinary course'' test. Do you think we need to include a test which requires a showing of some prior pattern of giving to ensure that this legislation cannot be used to commit fraud? Would a test requiring such a showing withstand free exercise scrutiny as applied to recent converts? If not, is there another way to balance the need to protect against fraud with the free exercise rights of donors?

A: The bill might plausibly have been drafted to require a showing that giving within the period of the statute of limitations prior to bankruptcy was consistent with a prior pattern of giving. But this is not essential, and it would increase the complexity of the standard and the expense of litigation. The 15% safe harbor in the current bill simplifies administration of the Act in the great bulk of cases in which there is no suspicious change in the pattern of giving.

Where there is a sudden change in the pattern of giving, this would be a badge of fraud, and the sharply increased gift could be challenged under 11 U.S.C. §548(a)(1) (1994). In practice, the fifteen percent safe harbor merely shifts the burden of proof, and confines litigation over changes in pattern to those few cases where there is prima facie evidence of a change in pattern large enough to be evidence of fraudulent intent.

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The free exercise rights of recent converts present fact questions that will only occasionally be difficult. If shortly before bankruptcy, a debtor suddenly gives 15% of his last year's income to the church, he will have a difficult time persuading the court that this resulted from a sudden conversion and not from a fraudulent intent. But it is a fact question, and probably an unavoidable one.

In the more typical case, the new convert will begin giving a larger fraction of each week's income to the church. These cases should be much easier. If this giving suddenly begins a few weeks before bankruptcy, the amount will not be significant and the result will not be important. By the time the amount has gown to something significant, the new convert will not be so new anymore; his bona fides will be evidenced by a sustained pattern of giving. So I think the current bill deals with the problem of new converts as well as it is possible to do.

Q 4: In your testimony, at page 11, you assert that protecting only religiously motivated donations could withstand Establishment Clause scrutiny. How do you square that position with the Supreme Court's ruling in *Texas Monthly?*

A: I think the case more in point is *Corporation of the Presiding Bishop* v. *Amos,* 483 U.S. 327 (1987), in which the Court unanimously held that Congress can create regulatory exemptions for religious organizations and religious conduct, and that these exemptions need not come packaged with benefits for secular organizations or secular conduct. *Amos* is quoted with approval and its principles reaffirmed in *Board of Education* v. *Grumet,* 512 U.S. 687, 705 (1994).

***Texas Monthly* v. *Bullock* 489 U.S.1(1989), was decided after *Amos* and before *Grumet,* mid it did not purport to overnile Amos. *There* is no opinion for the Court in *Texas Monthly.* I have always believed that *Texas Monthly* is about tax exemptions, not regulatory exemptions, tax issues raise special sensitivities under the Establishment Clause. I have also always believed that the core fact of *Texas Monthly* was that Texas engaged in viewpoint discrimination among competing publications—that it is as much a free speech case as an Establishment Clause case.**

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The Court's opinions on religious exemptions, including the plurality opinion in *Texas Monthly,* says that religious exemptions must be designed to lift a burden from the exercise of religion. The Court did not view the sales tax at issue in *Texas Monthly* as a significant burden. The tax was modest in amount and incidental to sales, each sale produced the revenue to pay the tax, and without a sale, there was no tax. But the fraudulent transfer suits addressed by these bills impose substantial liability at a time when there is no associated revenue with which to pay the liability. There is a substantial burden on religion here, and Congress is entitled to lift that burden.

Having said a that, I still think it is wise to include the secular charities. It is better policy; they are also deserving of relief from this burden even though they have no free exercise claim. And including them will avoid long and burdensome litigation over the Establishment Clause issue.

Q 5: Must gifts to religious and to non-religious charities, if made on the basis of a sincerely held religious belief, receive equal protection to withstand First Amendment challenge?

A: This is an insightful and difficult. Again I think it is best to protect both categories. I am not sure it is constitutionally required.

First, the religious charity that received a gift has its own free exercise claim not to have to divert current resources to repay that gift. The secular charity does not have such a claim, although some secular charities might have a free speech claim.

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Second, the donor with a religious motivation has a free exercise claim no matter who receives the contribution. But the religious motivation is usually obvious when the donor gives to a church or synagogue; proof of religious motivation may be difficult when the donor gives to a secular charity.

If Congress chose to enact an exemption for the case that is clearest in principle and easiest to litigate, and not to provide an exemption for cases that are less obvious and more difficult to litigate, the Court would probably uphold that choice. Compare *Gillette* v. *United States,* 401 U.S. 437 (1971), upholding the draft exemption for those who conscientiously object to war in any form and the denial of exemption to those who conscientiously object only to unjust wars.

Even though the Court might uphold a distinction between contributions to religious charities and religiously motivated contributions to secular charities, such a distinction would in fact discriminate between two related religious practices. This discrimination might well have uneven impact on different faiths. Including the secular charities solves the whole problem; it avoids discrimination between faiths, and it avoids difficult inquiries into motivation.

Q 6: If Congress allows charitable giving in chapter 13, should the legislation be extended to individual debtors in chapters 11 and 12?

A: Yes. I think that the failure to include chapters 11 and 12 up to this point is mere oversight, arising from the fact that most of the litigation has been under chapters 7 and 13. But an individual should be protected no matter what chapter he files under. An individual with a farm or a substantial unincorporated business may have no choice but to file under chapter 11 or 12, and he should get the same protections provided to an individual who files under chapter 13.

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Q 7: You proposed preempting all state fraudulent transfer statutes once a petition for bankruptcy relief is filed. If enacted, a creditor's rights would continue to exist under state law, but that right would be extinguished in bankruptcy and post-discharge. Would this cause certain creditors to race to the courthouse in anticipation of a bankruptcy filing? Would it create an incentive to counsel insolvent debtors to file for bankruptcy to protect church assets donated more than one year prepetition? Should this preemption be limited only to the extent that Congress protects charitable donations?

A: Taking the last question first, this preemption should be limited; state law should be preempted only to the extent that Congress protects charitable donations. In the amendment I proposed at page 13 of my testimony, the phrase ''such a transfer'' was intended to create this limitation; the reference was to transfers protected from §548(a)(2). Somewhat different language to accomplish the same purpose has now been added to the Senate bill.

Preemption is essential to make the rest of the bill effective. Otherwise, the bill will merely move the large dollar cases from federal court to state court. The *Cedar Bayou* case, now pending in state court in Texas, shows that this threat is real and not merely theoretical. *Cedar Bayou* represents the next logical move for creditors—

because the trustee would not file in Bankruptcy Court, the largest creditor filed in state court.

Preemption will conform these bills to the general preemption policy of the Bankruptcy Code. The general preemption provision in the Bankruptcy Code is the automatic stay. 11 U.S.C. §362 (1994). The filing of a petition in bankruptcy automatically stays all other suits against the debtor and all other attempts to recover property of the estate; this preempts a great variety of state court lawsuits as of the filing of the petition.

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But for technical reasons, the automatic stay would not preclude state fraudulent transfer actions after the enactment of H. R. 2604. The state lawsuit would be against the church or charity, not against the debtor. And the state lawsuit would not seek to recover property of the estate, because H. R. 2604 would effectively put contributions to charities outside the estate. So H.R. 2604 would actually open the door to state fraudulent transfer actions. This would be an unintended consequence, and preemption language is necessary to prevent it.

Preemption will not create a race to the courthouse. The bankruptcy proceeding controls even if it is filed after the state court litigation. The automatic stay stops most state court lawsuits, and the preference rules of §547 require the state plaintiff to give back anything he managed to recover on the eye of bankruptcy. Because everyone understands this, the state court litigation tends not to get filed, and everyone waits for the bankruptcy. Preemption language in these bills will subject fraudulent transfer actions to the same rules.

In the event that a creditor sued a church in state court, seeking to recover contributions made by a donor who was insolvent but who had not filed for bankruptcy, Mr. Nadler is right that the donor could give his church a defense by filing for bankruptcy. Whether he would do so would depend on the costs and benefits of bankruptcy to the debtor and on how much he cares to protect his church.

This situation will not arise often, because the creditors can anticipate this move and realize that filing the state action is unlikely to actually recover anything. The state action does not even have a chance of giving the aggressive creditor an advantage in bankruptcy, because the claim will disappear altogether when the bankruptcy is filed. More fundamentally, there is nothing unusual about a bankruptcy filing in response to an aggressive action by a creditor. Wage garnishments, lawsuits, and judgments are among the common last straws that force debtors to file for bankruptcy.

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Q 8: Section 3(a) of the Packard bill appears to allow multiple donations, each of which is less than 15% of gross annual income, even if the aggregate donation exceeded 15%. Do you believe, in the absence of a prior pattern of giving, that Congress should place an annual cap on giving or just a cap on individual gifts?

A: I believe the numerical safe harbor should be in terms of aggregate donations and not individual gifts. I had not focused on this feature of the bill, and I suspect that it may be an unintended drafting glitch. The point is of limited importance, because cumulative gifts in excess of 15% will be rare, and the courts might infer fraudulent intent in a high percentage of those few cases. Even so, I think an annual cap would be better. Section 3(a)(2) might be amended as follows:

A transfer of a charitable contribution to a qualified religious or charitable entity or organization shall not be considered to be a transfer covered under paragraph (1)(B) in any case in which—

(A) the aggregate of all such contributions to such entities for any twelve-month period does not exceed 15 percent of the gross income of the debtor for the same twelve-month period; or

(B) the aggregate of all such contributions to such entities for any twelve-month period exceeds the percentage amount of gross annual income specified in subparagraph (A), if the transfer was consistent with the practices

of the debtor in making charitable contributions.

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If the aggregate of all such contributions to such entities for any twelve-month period exceeds the limits set forth in this paragraph, only the excess shall be considered to be a transfer covered under paragraph (1)(B).

If a debtor gives 17% of his income in a year, and this is not consistent with his historic practices, 2% would be recoverable. If the contributions went to multiple charities, this leaves a question of which charity or charities are liable for the 2%. One answer implied by the present text is the unusual contribution—that individual contributions consistent with historic practice would be protected by (2)(B). Another answer could be to provide for pro rata liability, or to put liability on the charity that received the largest contribution, or to leave it to judicial discretion.

Q 9: The challenge of protecting individual religious practices on a case-by-case basis is that the practices of minority religions may not come to the attention of Congress prior to enactment. The 15% safe harbor may present such a challenge. Are you aware of any religions whose adherents believe in a larger tithe? Can Congress enact a numeric safe harbor without violating the neutrality rule enunciated in *Employment Division v. Smith?*

A: I have the same problem as Congress; there are many religions that I do not know about either. But I am not aware of any religion that teaches a duty on ordinary members to give more than 15% of their income to the religious organization.

Members of religious orders who take a vow of poverty often give 100% of their income to the religious order. But in these cases, the religious order generally undertakes to support the member, and the member generally forgoes business transactions and much consumer spending, Members of such orders seem unlikely to wind up in bankruptcy, and I am not aware of any such cases. In the absence of fraudulent intent, such cases would be covered by §3(a)(2)(B) of H.R. 2604, and that would be true of any other good faith pattern of contributions in excess of 15%.

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The 15% safe harbor serves to simplify litigation and allocate the burden of proof, it does not actually deny protection to believers that give more. I can imagine an argument that a believer who gives 16% is forced to prove a pattern, and that this is discriminatory as compared to a believer who gives 15%. But the additional burden is modest; the reason for dispensing with it in some cases is legitimate; the impossibility of dispensing with it in all cases is clear. Moreover, the language I have proposed in response to Question 8 would further minimize any difference in treatment. Even for the donor who gave 17%, the first 15% would still be protected by the safe harbor. All faiths could protect 15% without shifting the burden of proof, and all faiths could protect more if they proved a pattern of giving. I do not believe the Court would strike down the 15% safe harbor on the basis of any residual discrimination between faiths.

National Bankruptcy Conference
February 26, 1998.

Hon. GEORGE GEKAS,
Chairman, Subcommittee on Commercial and Administrative Law,
Committee on the Judiciary
House of Representatives, Washington, DC.

DEAR MR. CHAIRMAN: On February 12, 1998 you presided over a hearing of your Subcommittee. This hearing

concerned amendments to the Bankruptcy Code to exempt certain donations from fraudulent-transfer powers of bankrupt estates. At issue were H.R. 2604 and H.R. 2611.

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Stephen H. Case, Vice-chair of the Committee on Legislation, testified on behalf of the National Bankruptcy Conference ("NBC"). In his remarks, he stated that, while the NBC had not then researched the issue, legislation that exempted only donations to religious institutions might raise issues under the Establishment Clause of the First Amendment to the Constitution of the United States. You asked him if the NBC would address this issue in written form. This letter responds to your request.

I. Summary

Although thoughtful counter arguments can be made, and ultimately could win the day, a literal application of language in many pertinent Supreme court opinions suggests that a court could strike down a religion-only exemption from the fraudulent-conveyance powers as a violation of the Establishment Clause. Most significantly, if a court concluded that the fraudulent conveyance exemption had the effect of preferring religious institutions over non-religious organizations with comparable objectives, the court could find that the legislation violates the Establishment Clause. Due to the existence of some case law to the contrary, however, enactment of a religion-only exemption is likely to generate substantial litigation over this constitutional question.

II. Analysis

Here is the legal analysis upon which the foregoing conclusion is based.

A. Two Fundamental Post-War Cases

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(a) *Everson.* In 1947, in *Everson* v. *Board of Education,* 330 U.S. 1, the Supreme Court ruled that it did not infringe upon the Establishment Clause for a New Jersey municipality to provide transportation services for students, including those attending religious schools. With no one dissenting on the point, the Court stated that the Establishment Clause prohibits all of the following: legislation that "aids one religion;" legislation that "prefer[s] one religion over another;" and legislation that "*aid[s] all religions.*"(see footnote 36)

(b) *Lemon.* Collecting and refining prior precedents, the Court in *Lemon* v. *Kurtzman,* 403 U.S. 602 (1971) declared unconstitutional Rhode Island and Pennsylvania statutes providing financial aid for, among other things, the teaching of non-religious subjects in religious schools. Chief Justice Burger's opinion synthesized prior considerations to put forth three tests to guide Establishment Clause scrutiny. Explaining that there are "three main evils against which the Establishment Clause was intended to afford protection: 'sponsorship, financial support, and active involvement of the sovereign in religious activity,' "(see footnote 37) the Court delineated the following three tests, all Tree of which must be satisfied:

(1) the statute must have a secular legislative purpose;

(2) the statute's principal or primary effect must one that neither advances nor inhibits religion;(see footnote 38) and

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(3) the statute must not foster an excessive government entanglement with religions.(see footnote 39)

B. Specific Precedents Supporting Invalidity: Religious Organizations Cannot be Singled Out For Financial Benefit

Pointed dictum in the 1970 *Walz* cases(see footnote 40) may indicate that the First Amendment prevents legislatures from singling out churches or religions for financial benefit. At issue was a state tax exemption for real or personal property "used exclusively for religious, educational or charitable purposes"(see footnote 41) owned by an entity which did not seek profit and operated for one of the three purposes. The Court found the exemption valid under the Establishment Clause. In so ruling, the Court took pains to note that the tax exemption *did not single out churches for special protection.* Rather, the legislation aided all beneficent institutions on an equal basis, and did not give religious institutions any financial advantage.

Later cases arguably confirm the view that legislatures may not constitutionally single out religions for special financial benefit without spreading the same protection to other beneficent groups. *Compare Texas Monthly, Inc.* v. *Bullock*, 489 U.S. 1 (1989)(statute was unconstitutional which exempted only religious publications from local sales tax) *with Jimmy Swaggart Ministries* v. *California BE of Equalization,* 493 U.S. 378 (1990) (constitutional under the Establishment Clause for state to tax religious publications on the same basis as all other publications).

C. Corporation of Presiding Bishop v. *Amos Arguably Supports The Proposed Legislation But It Does Not Answer The Constitutional Issue Posed By The Legislation*

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The Supreme Court in *Corporation of Presiding Bishop* v. *Amos,* 483 U.S. 327 (1987), held that an exemption from Title VII's prohibition on employment discrimination that is granted exclusively to religious institutions did not violate the Establishment Clause. Although the bulk of the Court's analysis is devoted to the "entanglement" prong of the *Lemon* test, the fact remains that the exemption in *Amos* seems plainly aimed at protecting religion, but withstood scrutiny under the "purpose" and "effects" tests. Thus, notwithstanding *Everson* and its progeny, *Amos* casts some doubt on whether there is a simple rule that direct advancement of religion, by itself, violates the First Amendment.

Amos, like the other Supreme Court cases cited above, does not directly answer the particular question posed by the proposed legislation. The inherent tension between *Amos* and other decisions more closely aligned with *Everson* suggests that this issue likely would produce significant litigation.(see footnote 42)

D. Application of the Aforementioned Precedents

As the *Amos* case suggests, there is some support for the constitutionality of a religion-only exemption. The "purpose" test likely would not be violated by a religious fraudulent conveyance exemption, since accommodation of religion often is considered a permissible secular purpose. Likewise, the proposed exemption is not likely to raise significant "entanglement" issues. The "effects" test may be the most troublesome for a religion-only exemption, since there is considerable support for the notion that this test prohibits favoring religion over non-religion.(see footnote 43) Again, however, the outcome in the *Amos* case indicates that the probable outcome for a fraudulent transfer exemption is not crystal clear. To the extent that the Supreme Court construes bankruptcy legislation to avoid constitutional issues if it is possible to do so,(see footnote 44) it could follow the *Amos* rationale in considering the legislation at issue.

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E. Free Exercise Clause

As a separate matter, churches and their debtor-parishioners may argue that the lack of an exemption from fraudulent conveyance laws interferes with their rights under the Free Exercise clause of the First Amendment. Free Exercise rights were constrained considerably by *Employment Div. Dept. Of Human Resources of Ore.* v. *Smith,* 494 U.S. 872 (1990), in which the Supreme Court held that a neutral law of general applicability need not be justified by a compelling governmental interest, even if the law has the incidental effect of burdening a particular religious practice.(see footnote 45) In response to *Smith,* Congress enacted the Religious Freedom Restoration Act ("RFRA") to reinstate a test that would be more protective of religious exercise.(see footnote 46) The Supreme Court has invalidated RFRA as it applies to the states,(see footnote 47) but RFRA's more protective test arguably still applies to *federal* law

encroachments on religious exercise.(see footnote 48) Navigating between Free Exercise rights and Establishment Clause restraints is difficult; only the Supreme Court can say for sure how each of these clauses would affect the proposed legislation.

III. Conclusion

Based on the foregoing, albeit in cases involving facts, statutes, and contexts that are substantially different, we believe that there is a substantial basis to support a determination that the proposed legislation would be unconstitutional.

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We recognize that there is some countervailing precedent which ultimately could win the day. The existence of competing authority leads us to anticipate that a religion-only fraudulent conveyance exemption would produce protracted litigation ova its constitutionality and thus may not insulate religious organizations from costly court proceedings.

Thank you for considering these views.

Very truly yours,

J. Ronald Trost, *Chair*
The National Bankruptcy Conference.

51–375 CC

1998
RELIGIOUS LIBERTY AND CHARITABLE DONATIONS PROTECTIONS ACT OF 1997; AND RELIGIOUS FAIRNESS IN BANKRUPTCY ACT OF 1997

HEARING

BEFORE THE

SUBCOMMITTEE ON
COMMERCIAL AND ADMINISTRATIVE LAW

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OF THE
COMMITTEE ON THE JUDICIARY
HOUSE OF REPRESENTATIVES

ONE HUNDRED FIFTH CONGRESS

SECOND SESSION

ON

H.R. 2604

RELIGIOUS LIBERTY AND CHARITABLE DONATIONS PROTECTION ACT OF 1997

H.R. 2611

RELIGIOUS FAIRNESS IN BANKRUPTCY ACT OF 1997

FEBRUARY 12, 1998

Serial No. 65

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LETTERS, STATEMENTS, ETC., SUBMITTED FOR THE HEARING

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APPENDIX

(Footnote 1 return)

See Restatement (Second) of Contracts §90(2) (1981) (enforceable without reliance); Annotation, *Lack of Consideration as Barring Enforcement of Promise to Make Charitable Contribution or Subscription—Modern Cases,* 86 A.L.R.4th 241 (1991 & Supp.) (collecting cases); John D. Calamari & Joseph Perillo, *The Law of Contracts* §6–2(d) at 279–81 (3d ed. 1987); Arthur Linton Corbin, 1A *Contracts* §198 at 203–13 (2d ed. 1963); Samuel Williston, 1 *A Treatise on the Law of Contracts* §116 at 473–80 (3d ed. 1957); Edith L. Fisch, Doris Jonas Freed, & Esther R. Schachter, *Charities and Charitable Foundations* §63 at 77 (1974).

(Footnote 2 return)
Employment Division v. *Smith,* 494 U.S. 872 (1990).

(Footnote 3 return)
Morris v. *Midway Southern Baptist Church (In re Newman),* 203 B.R. 468 (D.Kan 1996); *Christians* v. *Crystal Ev. Free Church (In re Young),* 152 B.R. 939 (D.Minn. 1993), *reversed* 82 F.3d 1407 (8th Cir. 1996), *vacated and remanded,* **XXX** U.S. **XXX** (1997); *Weinman* v. *Word of Life Christian Center (In re Bloch),* 207 B.R. 944 (D. Colo. 1997); *Fitzgerald* v. *Magic Valley Ev. Free Church (In re Hodge),* 200 B.R. 884 (D. Idaho 1996).

(Footnote 4 return)
Lemon v. *Kurtzman,* 403 U.S. 602 (1971).

(Footnote 5 return)
In re Young, supra at 955. See also *In re Hodge, supra.*

(Footnote 6 return)
42 U.S.C. 2000bb (1993).

(Footnote 7 return)
City of Boerne v. *Flores,* **XXX** U.S. **XXX**, 117 S.Ct. 2157 (1997).

(Footnote 8 return)
In re Andrade, 213 B.R. 765 (E.D. CA. Oct. 10, 1997); *In re Saunders,* 214 B.R. 524 (D. Mass. July 17, 1997).

(Footnote 9 return)
In re Newman n. 2, *supra,* at 477.

(Footnote 10 return)
Id.

(Footnote 11 return)
Weinman v. *Word of Life Christian Center (In re Bloch),* 207 B.R. 944, l51 (D.Colo. 1997).

(Footnote 12 return)
See note 2, *supra.* These decisions were handed down prior to the passage of RFRA. However, they were applying the same "compelling government interest/least restrictive means" test that was later brought to bear on such cases by

RFRA.

(Footnote 13 return)
Fitzgerald v. *Magic Valley Ev. Free Church (In re Hodge)*, 200 B.R. 884 (Bankr.D.Idaho 1996), pending, No. 96–00458 (U.S.D.C., D. Idaho).

(Footnote 14 return)
E.g. *In re Hodge*, note 12 *supra.*

(Footnote 15 return)
In re Bloch, note 2 *supra; In re Hodge*, note 12, *supra.*

(Footnote 16 return)
Curiously, all but one of those cases were brought against evangelical Protestant churches.

(Footnote 17 return)
In re Young, note 2, *supra.*

(Footnote 18 return)
In re Newman, note 2, *supra.*

(Footnote 19 return)
In re Bloch, note 9, *supra.*

(Footnote 20 return)
In re Hodge, note 11, *supra.*

(Footnote 21 return)
Ellenberg v. *Chapel Hill Harvester Church, Inc. (In re Moses)*, 59 B.R. 815 (Bankr N.D.Ga. 1986); *Wilson* v. *Upreach Ministries (In re Missionary Baptist Fdn. of America)*, 24 B.R. 973 (Bankr. N.D.Tex. 1982).

(Footnote 22 return)
Section 522 of the Bankruptcy Code authorizes a myriad of exemptions to the claims of creditors: a debtor's home, life insurance policies, business tools or machinery, personal goods (up to a certain amount) and a great many other items of property purchased by the debtor. Similarly, Chapter 13 permits a broad and case-specific buffet of exceptions for legitimate personal expenditures.

(Footnote 23 return)
In re Chomakos, 170 B.R. 585 (Bankr. E.D. Mich. 1993).

(Footnote 24 return)
56 F.3d 750 (7th Cir. 1995), *cert. denied* 116 S.Ct. 673 (1995).

(Footnote 25 return)
11 U.S.C. §1325(a)(4).

(Footnote 26 return)
Members of the Church of Jesus Christ, Latter Day Saints are an exception.

(Footnote 27 return)
The NBC is a sixty-plus-year-old organization of 65 judges, professors and lawyers from 22 states dedicated to better federal bankruptcy law. The NBC is grateful to the Congress for having regularly considered its views for over 60 years.

(Footnote 28 return)
See, e.g., *Geltzer* v. *Cross Roads Tabernacle (In re Rivera),* 214 B.R. 101 (Bankr. S.D.N.Y.) (recovery of religious donation as fraudulent transfer did not violate First Amendment rights); *Weimnan* v. *The Word of Life Christian Center (In re Bloch),* 207 B.R. 944 (D. Col. 1997); *Morris* v. *Midwav So. Baptist Church (In re Newman),* 203 B.R. 468, 473–474 (D. Kan. 1996); *Fitzgerald* v. *Magic Valley Evangelical Free Church (In re Hodges),* 200 B.R. 884 (Bankr. D.Idaho 1996). *But see Wilson* v. *Upreach Ministries (In re Missionary Baptist Fndn of America),* 24 B.R. 973 (Bankr. N.Dak. 1982); and *Ellenbere* v. *Chapel Hill Harvester Church (In re Moses),* 59 B.R. 815 (Bankr. N.D. Ga 1986) (finding forms of"fair consideration" to support validity of transfer to charity). *Se* also Psalm 37, verse 21: "the wicked borrow and do not repay, but the righteous give generously."

(Footnote 29 return)
0nly churches and temples in the case of H.R. 2611.

(Footnote 30 return)
Each bill contains provisions which could limit the worst case to some extent. Neither H.R. 2604 as we read it (Are we correct in believing that the reference to "paragraph (1)(B) in Section 3(a)(7) of H.R. 2064 should be to "paragraph (B)(i)"?) nor H.R. 261 I would protect the donation where the donation was made with "actual intent to hinder, defraud or delay creditors". This will force trustees in bankruptcy to litigate intensively about the donor's state of mind when the contribution was made. These bills, in other words, as we read them will thus have two adverse elects: increases in expensive litigation and unfairness to creditors.

(Footnote 31 return)
Lawrence P. King, ed. **Collier on Bankruptcy** @ 548–20 (15th ed. 1996)(hereinafter "Collier").

(Footnote 32 return)
Collier @ 548–21.

(Footnote 33 return)
Collier @ 548–23.

(Footnote 34 return)
Collier @ 548–28 (citing *Richardson* v. *Germania Bank,* 263 F. 320 (2d Cir. 1919), *cert, denied,* 252 U.S. 582 (1920)).

(Footnote 35 return)
11 U.S.C. Sections 1225(b)(2) and 1325(b)(2).

(Footnote 36 return)
Everson, 330 U.S. at 15 (emphasis added).

(Footnote 37 return)
Lemon v. *Kurtzman,* 403 U.S. 602, 612 (1971), *citing Walz* v. *Tax Comm'n,* 397 U.S. 664, 668 (1970) ("for the men who wrote the Religion clauses of the First Amendment the 'establishment' of a religion connoted sponsorship, financial support, and active involvement of the sovereign in religious activity").

(Footnote 38 return)
A leading antecedent to the "sponsorship" prong of the *Lemon* test is *Abington School District* v. *Schempp,* 374 U.S. 203, 9 ' (1963), where the Court stated that the legislation passes constitutional muster only if there is "a secular legislative purpose and a primary effect that neither advances nor inhibits religion."

(Footnote 39 return)
Lemon, 403 U.S. at 612–613. A leading antecedent to the "active involvement" prong of Lemon is whether the governmental program results in an "excessive government entanglement with religion." *Walz* v. *Tax Comm'n,* 397 U.S. 664, 674 75 (1970).

(Footnote 40 return)
Walz., 397 U.S. at 674–75.

(Footnote 41 return)
Id.

(Footnote 42 return)
Cf. Thornton v. *Caldor,* 472 U.S. 703 (1985) (Declaring unconstitutional a Connecticut statute that prohibited employers from requiring an employee to work on a day that the employee recognizes as his Sabbath; statute had a primary effect that impermissibly advanced a particular religious practice).

(Footnote 43 return)
See Board of Education of Kiryas Joel Village School District v. *Grumet,* 512 U.S. 687, 696 (1994) [citations omitted].

(Footnote 44 return)
See, e.g., United States v. *Security Industrial Bank,* 459 U.S. 70 (1982).

(Footnote 45 return)
Smith, 494 U.S. at 879. *See also Church of the Lukumi Babalu Aye, Inc.* v. *City of Hialeah,* 508 U.S. 520 (1993).

(Footnote 46 return)
The Religious Freedom Restoration Act of 1993, 42 U.S.C. §2000bb et seq. (requiring, among other factors, consideration of whether government action "substantially burdens" religious practice and whether there is compelling government interest for that government action).

(Footnote 47 return)
The Supreme Court's opinion *City of Boerne* v. *Flores*, 117 S. Ct. 2157 (1997), addressed the application of RFRA to the states and held that the statute exceeded Congress' power to control state action under section 5 of the 14th Amendment.

(Footnote 48 return)
But see Flores, 117 S. Ct. at 2172 (Stevens, J. concurring) (noting his view that RFRA violates Establishment Clause); In re Saunders, 96–16009–WCH, 1997 WL 77064 (Bankr. D. Mass. Dec. 1, 1997) (holding that RFRA violated Establishment Clause and thus did not insulate tithing in Chapter 13).