IRB 2021-47
11/22/2021

ACTION ON DECISION

Subject: *Mayo Clinic v. United States*, 997 F.3d 789 (8th Cir. 2021), *rev'g,* 412 F.Supp.3d 1038 (D. Minn. 2019).

Issue: Is an organization described in section 170(b)(1)(A)(ii) of the Internal Revenue Code if the presentation of formal instruction is not its primary function?

Discussion: Under section 514(c)(9)(C), qualified organizations, including organizations described in section 170(b)(1)(A)(ii), may be exempted from the tax on unrelated business taxable income imposed by section 511 with respect to income derived from or on account of certain debt-financed real property. Section 170(b)(1)(A)(ii) describes "an educational organization which normally maintains a regular faculty and curriculum and normally has a regularly enrolled body of pupils or students in attendance at the place where its educational activities are regularly carried on." Treas. Reg. § 1.170A-9(c)(1) provides, in part, that "[a]n educational organization is described in section 170(b)(1)(A)(ii) if its primary function is the presentation of formal instruction," and if its noneducational activities are merely incidental to its educational activities.[1]

In *Mayo Clinic v. United States*, 412 F.Supp.3d 1038, 1057 (D. Minn. 2019), *rev'd*, 997 F.3d 789 (8th Cir. 2021), the district court held that Mayo Clinic was a qualified organization under section 514(c)(9) because it "qualifies as an 'educational organization' under § 170(b)(1)(A)(ii)." The Government conceded that Mayo Clinic "normally maintains a regular faculty and curriculum and normally has a regularly enrolled body of pupils or students in attendance at the place where its educational activities are regularly carried on" (the faculty-curriculum-student-place requirement). 412 F.Supp.3d at 1057. Nonetheless, the Government argued that Mayo Clinic was not an "educational organization" within the meaning of section 170(b)(1)(A)(ii) because, under the regulation, its primary function was not the presentation of formal instruction. However, the district court held that, because "the primary-function and merely-incidental requirements in 26 C.F.R. § 1.170A-9(c)(1) * * * exceed the bounds of authority given by 26 U.S.C. § 170(b)(1)(A)(ii), they are unlawful" and, therefore, that "there is no genuine issue of material fact that Mayo [Clinic] qualifies as an 'educational organization' under § 170(b)(1)(A)(ii)." *Id.* The Government appealed.

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[1] Under section 509(a)(1), domestic or foreign organizations described in section 501(c)(3) that are educational organizations described in section 170(b)(1)(A)(ii) are not private foundations.

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The Eighth Circuit reversed and remanded to the district court, concluding that the regulation was valid, in part. Explaining that "an 'educational organization' as used in § 170(b)(1)(A)(ii) must be 'organized and operated exclusively for * * * educational purposes,'" the Eighth Circuit determined "it is valid to interpret the statute as requiring that a qualifying organization's primary purpose be 'educational' and that its *noneducational* activities be merely incidental to that primary purpose." 997 F.3d at 800 (emphasis original). However, the Eighth Circuit examined the history of the precursors to section 170(b)(1)(A)(ii), including section 501(c)(3), and determined that the "requirement that the organization's 'primary function [must be] the presentation of formal instruction' has no long history of congressional acceptance." *Id.* at 799. The Eighth Circuit therefore held that, "[t]hough the regulation unreasonably limits 'educational organizations' to those principally providing 'formal instruction,' the terms 'primary function' and 'merely incidental' activities have a valid role in interpreting the statute." *Id.* at 799-800.

We disagree with the Eighth Circuit's invalidation of the long-standing regulatory requirement that the primary function of an educational organization described in section 170(b)(1)(A)(ii) must be formal instruction (the formal instruction requirement). First, in concluding that the formal instruction requirement "has no long history of congressional acceptance," the Eighth Circuit did not consider the numerous times Congress has amended section 170(b), increasing the percentage of the allowable deduction and adding to the categories of organizations eligible for the preferential allowable deduction, since the regulations under section 170(b)(1)(A)(ii) were published in 1958, which is persuasive evidence of Congressional acceptance of such regulations. *See*, *e.g.*, *CFTC v. Schor*, 478 U.S. 833, 846 (1986) ("It is well established that when Congress revisits a statute giving rise to a longstanding administrative interpretation without pertinent change, the 'congressional failure to revise or repeal the agency's interpretation is persuasive evidence that the interpretation is the one intended by Congress.'"). Second, the Eighth Circuit did not consider that the faculty-curriculum-student-place requirement provides a statutory basis for the formal instruction requirement in the regulations. Finally, the Eighth Circuit did not consider the Government's arguments regarding over one dozen Code sections cross-referencing section 170(b)(1)(A)(ii) (many of which predated the regulation's 1958 publication), which further support the position that the purpose of the formal instruction requirement is to ensure that section 170(b)(1)(A)(ii) "could not reach very far, if at all, beyond schools, colleges, and universities in its coverage." *Brundage v. Commissioner*, 54 T.C. 1468, 1474 (1970).

Although we disagree with the decision of the Eighth Circuit in *Mayo Clinic* with respect to the formal instruction requirement, we recognize the precedential effect of the decision to cases appealable to the Eighth Circuit and will follow it for cases within the Eighth Circuit in which the facts are not materially distinguishable. We do not, however,

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acquiesce to the opinion and will continue to litigate the formal instruction requirement in cases in other circuits.

The IRS will continue to apply the statutory faculty-curriculum-student-place requirement of section 170(b)(1)(A)(ii) because this requirement was not before, and therefore not considered by, either the district court or the Eighth Circuit. Furthermore, the IRS will continue to apply the regulatory requirement expressly affirmed by the Eighth Circuit that the term “educational organization” does not include an organization “engaged in both educational and noneducational activities unless the latter are merely incidental to the educational activities.”

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Recommendation: Nonacquiescence

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