

B. UPDATE ON PRIVATE SCHOOLS AND IMPACT OF BOB JONES UNIVERSITY v. U. S.

1. Introduction

In the private school area, 1983 was dominated by a single event, the issuance of the Supreme Court's long-awaited decision in the consolidated cases of Bob Jones University v. U.S. and Goldsboro Christian Schools, Inc. v. U.S. This topic will review the Supreme Court decision and other matters affecting the Service's treatment of private schools and it will also discuss the potential ramifications of the Bob Jones decision and its public policy rationale in other areas such as sex discrimination.

As the material presented here represents only the more recent events in what has been a very active area of exempt organizations tax law for a number of years, you may wish to refer to the Exempt Organizations Annual Technical Review Institutes texts and Continuing Professional Education Technical Instruction Program texts, beginning with the 1979 edition, for a review of events leading up to the Bob Jones decision.

2. Review of 1983 Litigation Developments

In the fall of 1981, the Supreme Court agreed to hear the cases of Bob Jones University v. U.S., 639 F. 2d 147 (4th Cir. 1980), and Goldsboro Christian Schools, Inc. v. U.S. No. 80-1473 (4th Cir. 1981), aff'g 436 F. Supp. 1314 (E.D.N.C. 1977), involving racial discrimination based on religious belief.

In Bob Jones, involving a claim for refund of FUTA tax as a vehicle for challenging revocation of exemption, the government had lost at the initial Federal District Court level in South Carolina. That Court held that the revocation of the University's tax-exempt status on the grounds of racial discrimination exceeded the Service's delegated powers, was improper under Service procedures, and violated the University's rights under the Freedom of Religion Clauses of the First Amendment to the Constitution.

The Fourth Circuit Court of Appeals, in a divided opinion, reversed the District Court and concluded that IRC 501(c)(3) must be read against the background of charitable trust law. In order to be exempt under that section, the Court reasoned, an institution must be "charitable" in the common law sense and

must not, therefore, be contrary to clearly defined public policy. The Court then concluded that the University's racial policies violated a clearly defined public policy against racial discrimination in education. The Court also rejected the University's other arguments, including the First Amendment claim. Bob Jones University appealed the decision to the Supreme Court.

In Goldsboro, the Federal District Court in North Carolina ruled in favor of the Service on a claim for refund of FICA and FUTA taxes based on a finding that Goldsboro was not described in IRC 501(c)(3) as it maintained a racially discriminatory admissions policy. The District Court decision was affirmed on appeal to the Fourth Circuit and the school appealed to the Supreme Court.

As discussed in the 1983 CPE text, on January 8, 1982, while preparations were being made for oral arguments before the Supreme Court, the Treasury Department announced a change in policy under which Bob Jones University and Goldsboro Christian Schools would be recognized as exempt under IRC 501(c)(3) and the revenue rulings and revenue procedures dealing with private schools and racial discrimination would be revoked. Treasury stated that, after a thorough legal review, they were unable to support the legal authority concerning public policy asserted by the Service in denying tax exemption to racially discriminatory private schools. Also, on January 8, the Department of Justice filed a motion with the Supreme Court asking that the Court of Appeals decisions in Bob Jones and Goldsboro be vacated.

The response to the Treasury announcement, including Congressional resolutions and hearings, was widespread, immediate, and generally negative. The issuance of an injunction in Wright (see 1983 CPE text, page 15), caused the Justice Department to modify its January 8 request to the Supreme Court and ask that the cases be heard. The revenue rulings and revenue procedures concerning private schools were not revoked. Justice, however, continued to argue that the Service did not have the statutory authority to revoke or deny exemption under IRC 501(c)(3) based on a determination that a public policy against racial discrimination in education had been violated by the two institutions.

On May 24, 1983, the Supreme Court issued its decision in which it ruled, eight to one, that educational institutions practicing racial discrimination based on religious beliefs are not charitable in the common law sense and are thus not entitled to federal income tax exemption. The Court's decision affirmed the Service position enunciated in Rev. Rul. 71-447, 1971-2 C.B. 230.

Chief Justice Warren Burger, in the majority opinion, reviewed the history of tax exemption for charities beginning with English common law and stated that, more than a century ago, the Supreme Court, in Perin v. Carey, 24 How. 465 (1861), noted that a gift for public charitable purposes would be legally sustainable provided it was consistent with local laws and public policy. Chief Justice Burger then described the origins and extent of the federal public policy against racial discrimination and racial discrimination in education in particular, citing court decisions, legislation, and executive orders. The Court stated that there can be no question that the Service's interpretation of IRC 170 and IRC 501(c)(3) is correct although "belated." Citing Norwood v. Harrison, 413 U. S. 455 (1973), the Court stated that it would be wholly incompatible with the concepts underlying tax exemption to grant exemption to racially discriminatory educational entities. The schools' First Amendment arguments were rejected on the grounds that the governmental interest in eradicating racial discrimination in education substantially outweighs whatever burden denial of tax benefits places on the schools' exercise of their religious beliefs.

The Supreme Court action in Bob Jones affected the litigation in Green v. Regan during 1983. The permanent injunction in Green requires the Service to withhold income tax exemption under IRC 501(c)(3) from, and to deny deductions for contributions to, any Mississippi private school not demonstrating a racially nondiscriminatory policy as delineated in the Green Court's May 5 and June 2, 1980, orders. On July 13, 1981, the Green Court suspended its injunctive orders as to church-operated schools on the motion of the government. This motion was filed because of the intervention of Clarksdale Baptist Church, which argued that denial of exemption would unconstitutionally infringe the First Amendment Rights of church-operated private schools whose racial policies were religiously based. The Court agreed to suspend its injunction as to church-operated private schools in Mississippi until the Supreme Court decided the issue in the Bob Jones University and Goldsboro Christian Schools cases. On July 22, 1983, shortly after the Supreme Court decided those cases against Bob Jones and Goldsboro, the Green Court ruled that its permanent injunction did not violate the Constitutional rights of church-operated schools in Mississippi. However, the Green Court continued its stay order for a short period of time in anticipation of an appeal being taken by Clarksdale Baptist Church. On August 18, 1983, the Court of Appeals for the District of Columbia denied intervenor Clarksdale's request for a continued stay of the District Court's order while the appeal was pending. On September 7, 1983, Justice Brennan of the Supreme Court also refused to stay the District Court action. The full Supreme Court similarly refused to stay the action on October 3, 1983.

Accordingly, the Service is now carrying out the Green Court's injunctive orders as they relate to church-operated Mississippi private schools.

A final litigation development during 1983 concerns the pending Supreme Court case of Regan v. Wright. The Court has agreed to hear the question of whether a federal court may entertain a plaintiff's suit that seeks to change agency procedures without alleging an actual injury. In Wright, the parents of black students attending public schools in a number of states other than Mississippi have sought to enjoin the Service from granting or continuing the tax exemption of private schools having insufficient minority enrollment unless the Service adopts more restrictive procedures for denying tax exemption to racially discriminatory schools. The plaintiffs are requesting that affirmative action guidelines similar to those mandated by the Green Court for Mississippi private schools be applied nationwide. The Court of Appeals for the District of Columbia granted plaintiffs' standing to sue without a showing that, as a result of any action by a private school or the Service, their children had suffered any discriminatory action or exclusion. As indicated, the Supreme Court has agreed to review the decision.

3. Review of 1983 Legislative Developments

The tuition tax credit proposal discussed in the 1983 CPE text was resubmitted to Congress by President Reagan on January 16, 1983. However, on November 16, 1983, the Senate voted down the measure. The Education Opportunity and Equity Bill of 1983 (S. 528) would have allowed families with adjusted gross income of \$40,000 or less a tax credit equal to 50 percent of tuition expenses for each child attending a private primary or secondary school, up to a maximum of \$100 in 1983, \$200 in 1984, and \$300 in 1985 and thereafter. The amount of the credit would have been reduced for families with adjusted gross incomes between \$40,000 and \$60,000, and eliminated for families with adjusted gross incomes in excess of \$60,000. The credit would not have been available for tuition paid to racially discriminatory private schools.

The Economic Equity Act of 1983 (H.R. 2090), concerning a number of child support, dependent care, insurance nondiscrimination, and retirement matters, contains a provision adding a new subsection 501(k) to the Code which would provide that, for purposes of IRC 501(c)(3), the term "educational purposes" includes the providing of nonresidential dependent care of individuals providing that the dependent care is for the purpose of enabling individuals to be gainfully employed and the services provided by the organization are available to the general public. The bill has not yet been reported out of committee. For a discussion on the

current Service rulings position on organizations providing childcare services, refer to the discussion on private schools and childcare in the 1983 CPE text.

4. Impact of Bob Jones Decision and the Public Policy Rationale for Denial of Exemption

In addition to the private schools area, the issue of public policy and federal income tax exemption has also arisen with regard to organizations which, through actions of their officers, directors or employees, have committed illegal acts. The issue arose in the context of purported illegal activities in the case of The Synanon Church v. United States of America, USDC DC, Civ. Action 82-2303. The Department of Justice, in a brief filed July 11, 1983, argued that evidence of alleged violent and illegal acts undertaken by Synanon would preclude entitlement to exemption under IRC 501(c)(3). These unlawful acts, according to Synanon's own records, included conspiracy to commit murder, assault and battery, and the cover-up of those activities through destruction of evidence, suborning of perjury and the commission of perjury. Citing the Bob Jones decision, the Department of Justice argued that an organization which seeks the support and subsidy of the American public through tax exemption must confer a benefit on the public and not be at odds with common community conscience to undermine that public benefit. Consequently, Synanon's illegal activities violated the purpose of a charitable trust and established public policy.

The government, in complying with a Tax Court order to present legal arguments on the application of charitable public policy requirements to an organization's tax exempt status, filed a brief on August 22, 1983, in the case of Church of Scientology of California v. Commissioner of Internal Revenue, Doc. No. 3352-78. This brief focuses on the single issue of whether the organization's pattern of egregious illegal actions, including break-ins of government buildings, the theft of government property and harassment of government officials, precluded its continued right to exemption because it violated public policy through a conspiracy to impede and obstruct the Service in carrying out its essential governmental function.

Public policy as a basis for denial or revocation of exempt status has been limited to the areas of racial discrimination in education and illegal activity. The positions of all three branches of the federal government are usually clear and uniform in these two areas. Public policy in other areas, such as sex discrimination in education, is not so clearly and uniformly established. Title IX of the Education Amendments of 1972, Section 901 et seq., 20 U.S.C.A. section 1681 et seq., for

instance, concerning sex discrimination in education, contains several exceptions, including the fact that it does not apply to institutions which have traditionally discriminated on the basis of sex. In the absence of a clear statement of overriding public policy such as the adoption of an Equal Rights Amendment to the U.S. Constitution, the public policy against sex discrimination in education has not yet been recognized as being as basic or fundamental as the policy against racial discrimination.

The necessity for definitive action such as the Equal Rights Amendment to bring sex discrimination to the level of racial discrimination is supported by the Bob Jones decision in which the Supreme Court stated that its opinion does not warrant an interpretation that the Service has authority to decide which policies are sufficiently "fundamental" to require denial of exempt status. The Service will continue to be guided by the actions of the executive, the legislative, and the judicial branches of government when determining whether public policies have become sufficiently fundamental and so clearly established as to require denial of tax exemption.

In a potentially significant non-tax case, the Supreme Court has before it Grove City College v. Bell, 687 F. 2d 684 (3rd Cir. 1982), concerning the scope of the federal law barring sex discrimination in federally funded educational programs under Title IX. This case, by implication, could also affect not only the question of sex discrimination but also similar laws proscribing discrimination against minorities and the handicapped. While the Department of Justice in oral arguments on November 29, 1983, urged the Court to adopt a narrow interpretation of the law that would hold that sex discrimination in one federally funded program does not bar federal aid for other programs of the school, the Court of Appeals decision rejected a program-specific approach and held that the College did not have a First Amendment Right to discriminate citing a case involving Bob Jones University and the disallowance of veterans benefits. The interpretation adopted by the Court of Appeals was supported at the Supreme Court by amicus briefs. The College argued that it should not be subject to Title IX as it receives only indirect federal assistance in the form of federally supported student aid. A broadly worded Supreme Court decision incorporating Constitutional principles could have an impact on how the public policy against sex discrimination is interpreted. A decision is expected this spring.

The Bob Jones decision has an impact also in the area of scholarship granting organizations. Where eligibility for scholarships is restricted to individuals of a particular race, the focus of Service inquiry should be on whether

the scholarship granting organization involved actually fosters racial discrimination in education thus violating the public policy described in Bob Jones. Such a determination regarding the effect of a racial restriction involves a review of all the facts and circumstances in a particular case. For instance, a private educational trust that awards scholarships only to Caucasian students to attend a predominantly minority school could be said actually to discourage racial discrimination in education. On the other hand, scholarships for Caucasian students to attend a school that has a racially discriminatory policy would clearly foster racial discrimination in education and, therefore, would not qualify for exemption under IRC 501(c)(3). Similarly, if the school in question had a racially nondiscriminatory policy but the trust's racially restrictive scholarship grants accounted for a comparatively large share of the total financial assistance available to students at the school, then the trust might detract from the school's nondiscriminatory policy and not operate exclusively for charitable and educational purposes within IRC 501(c)(3). Such a trust might not qualify for recognition of exemption under IRC 501(c)(3). The preceding examples highlight the necessity to analyze racially restrictive scholarship granting organizations on a case-by-case basis.

The Bob Jones decision reflects a fundamental public policy against racial discrimination in education. The Service is guided by such demonstrable evidence of fundamental public policies requiring uniform federal response in particular areas of concern. The Service will continue to analyze policy developments, as in the area of sex discrimination, to determine the impact, if any, on the administration of the federal tax laws.