

## F. UPDATE ON PRIVATE SCHOOLS

### 1. Introduction

During the preceding year, the issue of private schools and racial discrimination once again became a topic of intense public interest. The historical events concerning the Service position on private schools will not be reviewed as they have been extensively discussed in prior CPE texts. This discussion will focus on developments occurring in late 1985 and 1986, including events surrounding the restoration of federal income tax exemption to Prince Edward School Foundation of Farmville, Virginia. It will also note recent developments involving IRC 501(k).

### 2. Legislative Developments

As widely reported in the news media, in August, 1985, the Internal Revenue Service issued a ruling restoring the federal income tax exemption under IRC 501(c)(3) of Prince Edward School Foundation, a Virginia private school that had been described as racially discriminatory by a number of federal courts including the U.S. Supreme Court. See Prince Edward School Foundation v. Commissioner, 478 F. Supp. 107 (DDC 1979), aff'd, No. 79-1622 (DC Cir. July 30, 1980), cert. den., 450 U.S. 944 (1981), and Griffin v. County School Board of Prince Edward County, 377 U.S. 218 (1964). As a result of the ruling, Commissioner Roscoe Egger testified at public hearings on November 1, 1985, and again on April 28, 1986, before the House Ways and Means Oversight Subcommittee. The Subcommittee exhaustively reviewed the requirements for federal income tax exemption applicable to private schools, the Service administrative procedures used to process applications for exemption from private schools, and the particular circumstances of Prince Edward School Foundation.

After the hearings, on July 14, 1986, Rep. Rangel introduced two bills in the House concerning private schools. H.R. 5158 would amend the Code to deny tax exempt status to educational institutions that have been found to have a policy of racial discrimination against any group in enrollment, hiring, or in other areas. The institutions would continue to be ineligible for exemption until such time as they clearly and convincingly demonstrated that they had abandoned their former policy through vigorous, affirmative, and continued corrective action towards the discriminated group.

H.R. 5159 would amend the Code to specifically deny tax exemption to Prince Edward School Foundation until the school has completed a two year period of operations in a racially nondiscriminatory manner as evidenced by enrollment of more than a token number of black students, the employment of black faculty, and the employment of blacks in administrative and clerical positions.

Neither H.R. 5158 nor H.R. 5159 was passed by the House before adjournment. The Subcommittee, however, continues to have an active interest in the Service's administration of the private school area. The Subcommittee has requested that the Service provide it with quarterly status reports on private school developments.

### 3. Litigation Developments

On August 20, 1986, the Fourth Circuit Court of Appeals affirmed the Tax Court decision in Virginia Education Fund v. Commissioner, 85 T.C. No. 44 (1985). The Fund's IRC 501(c)(3) status had been revoked on the basis that it provided funds to racially discriminatory private schools in Virginia. The Tax Court had concluded that the burden was on the Fund, rather than the Service, to demonstrate that the recipients of its funds were racially nondiscriminatory.

### 4. Administrative Developments

On July 1, 1986, two general counsel memoranda were made public that concern private schools. The two documents, G.C.M. 39524 and G.C.M. 39525, conclude that private schools with a history of racial discrimination must establish, through objective and convincing evidence, that they now operate in a good faith racially nondiscriminatory manner in order to be recognized as exempt under IRC 501(c)(3). The "good faith operation" requirement is set forth in section 2.02 of Rev. Proc. 75-50, 1975-2 C.B. 587. Whether a particular private school is racially discriminatory or not has, of course, been the subject of a number of federal court decisions including Green v. Connally, 330 F. Supp. 1150, aff'd sub nom. Coit v. Green, 404 U.S. 997 (1971), Norwood v. Harrison, 382 F. Supp. 921 (N.D. Miss. 1974), Brumfield v. Dodd, 425 F. Supp. 528 (E.D. La. 1976), Bob Jones University v. U.S., 461 U.S. 574 (1983), and the aforementioned litigation involving Prince Edward School Foundation. Factors considered significant by the courts in assessing the nondiscriminatory nature of a school's operations include whether or not the private school was established at the time of local public school desegregation, whether the private school has ever enrolled black students or

employed black faculty, and to what extent the private school has attempted to make the local black community aware of its policies.

## 5. Day Care Organizations

We have been informed that Chief Counsel has closed, without publication, the regulations drafting project under IRC 501(k) in order to better allocate resources to meet the priorities of the Tax Reform Act of 1986. It is anticipated that guidance in interpreting IRC 501(k) will be developed through other means. In the interim, in view of the lack of published precedent under IRC 501(k), consideration should be given to national office referral of determination cases raising IRC 501(k) issues pursuant to IRM 7664.1.

## 6. Conclusion

As described in the preceding discussion, private schools and racial discrimination remain matters of significant interest to the general public, to Congress, and to the Service. It is likely that further developments will occur. It should be noted that private school determination cases remain subject to mandatory post review pursuant to the special selection procedures of IRM 7(12)14.3. The recent modifications of the post review program did not affect the special selection procedures.