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## THE TAX STATUS OF THE MODERN LABOR UNION

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In 1958, and again in 1959, President Eisenhower recommended legislation which would have empowered the Secretary of Labor to remove a union's tax exemption as a sanction against labor misconduct. This proposal, although not embodied in the Labor-Management Reporting and Disclosure Act,<sup>1</sup> served to focus attention, however briefly, on an aspect of labor unions rarely exposed to public scrutiny. The recent outpouring of legal commentary on labor activities has centered almost exclusively on the problems inherent in defining and proscribing unfair labor practices,<sup>2</sup> and in uncovering and combatting union corruption.<sup>3</sup> Virtually ignored by the legal writers has been the tax status of unions.<sup>4</sup> An understanding of this status, however, is essential to

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<sup>1</sup> 73 Stat. 519 (1959), 29 U.S.C.A. §§ 401-531 (Supp. 1961).

<sup>2</sup> See, e.g., Schwartz, *The Penumbra of State Regulation of Unfair Labor Practices*, 38 B.U.L. REV. 553 (1958); Comment, 11 STAN. L. REV. 565 (1959); 107 U. PA. L. REV. 876 (1959).

<sup>3</sup> See, e.g., Englander, *What's So Odd About Honesty?*, 10 LAB. L.J. 188 (1959); Shade, *The Problem of Union Corruption and the Labor-Management Reporting and Disclosure Act of 1959*, 38 TEXAS L. REV. 468 (1960); Wayman, *Management's Share in Labor Scandals*, 26 TENN. L. REV. 364 (1959).

<sup>4</sup> Only one brief review of the labor exemption, containing no discussion of its policy, can be found. See Note, *Open Season on Tax Loopholes—Should Section 101 Be Modified?*, 38 GEO. L.J. 620 (1950). Congress has also ignored the exemption. Typical is the statement by Representative Mills, who as Chairman of the House

an evaluation of the labor union as an economic entity and particularly as a participant in the collective bargaining process. This Article will, therefore, attempt to describe the current tax position of labor unions, and to appraise the relationship between the Code's treatment of unions and labor's role in modern society. The potential dangers inherent in that relationship will also be discussed.

## I. THE DEVELOPMENT OF LABOR'S TAX STATUS

### A. History of Section 501(c)(5)

A provision exempting labor unions has appeared in every income tax statute enacted since the adoption of the sixteenth amendment,<sup>5</sup> and now appears as section 501(c)(5) of the Internal Revenue Code of 1954. Yet during its entire history, only one reported statement of its policy by a member of Congress can be found.<sup>6</sup>

The special treatment accorded unions did not originate in an income tax statute, but in an excise tax. The first income tax,<sup>7</sup> enacted in 1894 and declared unconstitutional in 1895,<sup>8</sup> did not specifically refer to unions, though it did provide:

That nothing herein contained shall apply to . . . associations organized and conducted solely for charitable, religious, or educational purposes, including fraternal beneficiary societies, orders, or associations operated upon the lodge system and providing for the payment of life, sick, accident, and other benefits to the members of such societies.<sup>9</sup>

The excise tax of 1909, however, which placed a tax of one per cent on the net income exceeding \$5000 of certain forms of profitmaking enterprises,<sup>10</sup> specifically provided that "nothing in this section . . .

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Ways and Means Committee is the one Congressman most responsible for tax legislation: "Very frankly, I must admit that I have devoted a lot less time and thought to the area of tax-exempt organizations than to almost any other area of the [tax] law." *Panel Discussion on Tax Revision Before the House Committee on Ways and Means*, 86th Cong., 1st Sess. 1100 (1959).

<sup>5</sup> Tariff Act of 1913, ch. 16, § II(6)(a), 38 Stat. 172; Revenue Act of 1916, ch. 463, § 11(a)(1), 39 Stat. 766; Revenue Act of 1918, ch. 18, § 231(1), 40 Stat. 1076; Revenue Act of 1921, ch. 136, § 231(1), 42 Stat. 253; Revenue Act of 1924, ch. 234, § 231(1), 43 Stat. 282; Revenue Act of 1926, ch. 27, § 231(1), 44 Stat. 39; Revenue Act of 1928, ch. 852, § 103(1), 45 Stat. 812; Revenue Act of 1932, ch. 209, § 103(1), 47 Stat. 193; Revenue Act of 1934, ch. 277, § 101(1), 48 Stat. 700; Revenue Act of 1936, ch. 690, § 101(1), 49 Stat. 1673; Revenue Act of 1938, ch. 289, § 101(1), 52 Stat. 480; Int. Rev. Code of 1939, subch. 1, § 101(1), 53 Stat. 33.

<sup>6</sup> See note 14 *infra* and accompanying text.

<sup>7</sup> Revenue Act of 1894, ch. 349, §§ 27-33, 28 Stat. 553-57.

<sup>8</sup> *Pollock v. Farmers' Loan & Trust Co.*, 157 U.S. 429 (1895).

<sup>9</sup> Revenue Act of 1894, ch. 349, § 32, 28 Stat. 556.

<sup>10</sup> Act of Aug. 5, 1909, ch. 6, § 38, 36 Stat. 112. This tax was upheld in *Flint v. Stone Tracy Co.*, 220 U.S. 107 (1911).

shall apply to *labor*, agricultural or horticultural organizations, or to fraternal beneficiary societies . . . .”<sup>11</sup> Because the tax was tacked onto the bitterly contested Payne-Aldrich Tariff, it received little congressional or public attention, and the exemption received even less consideration. The only reference to the section in the legislative history was in response to a question about fraternal beneficiary societies. The Chairman of the Senate Finance Committee included labor unions in his response that “the committee is of opinion that they are not included within the provisions of this bill, and it does not intend to have them included.”<sup>12</sup>

This excise tax exemption was incorporated in the first income tax statute passed after the ratification of the sixteenth amendment,<sup>13</sup> apparently with little if any critical deliberation. The legislative history was again uninformative and the only recorded statement of congressional policy is a later remark by Senator McCumber:

Take a labor union, for instance. While it is organized to secure better wages for laborers and better conditions it does not do business at a profit; it is not organized for profit at all, except in a general way for the benefits to be derived from it and like organizations . . . . [G]enerally when we speak of a labor organization . . . we do not have in mind those organizations which are doing business for profit.<sup>14</sup>

### B. *The Scope of the Exemption*

The scope of the exemption provided by section 501(c)(5) is not expressly limited. The statutory term “labor organizations” is nowhere defined, but this apparently unconditional grant of immunity has been administratively qualified and judicially restricted.

In 1920, the Treasury considered the tax status of a business enterprise owned and controlled by a union but not a part of it as such. The sole purpose of the business was to provide employment for union members; all profits were remitted to the union treasury.<sup>15</sup> The exemption was denied on the ground that the activity of the enterprise did not differ significantly from an ordinary business venture.<sup>16</sup> Four years later, however, the Treasury allowed an exemption to a corporation

<sup>11</sup> Act of Aug. 5, 1909, ch. 6, § 38, 36 Stat. 113. (Emphasis added.)

<sup>12</sup> 44 CONG. REC. 3937 (1909) (remarks of Senator Flint).

<sup>13</sup> Tariff Act of 1913, ch. 16, § II(G)(a), 38 Stat. 172.

<sup>14</sup> 61 CONG. REC. 5958 (1921). Subsequent discussion turned to unions which might operate stores or banks, with some Senators stating that unions should be taxable on profits from those activities. This suggestion was not implemented until 1950. See note 41 *infra* and accompanying text.

<sup>15</sup> 2 CUM. BULL. 211 (1920).

<sup>16</sup> *Ibid.*

which had been formed by several labor organizations for the purpose of publishing a newspaper.<sup>17</sup> The paper, which accepted no advertising, was designed to publicize the activities of the member organizations and to print items of interest to labor. Evidently the corporation was not intended to be operated at a profit, since the costs of publication were met exactly by contributions of the stockholders. The Treasury based its decision on the theory that "what each of the labor organizations may do individually they may do collectively, and that a corporation organized and operated for the sole purpose of publishing a paper under the circumstances of the instant case is entitled to exemption as a labor organization . . . ." <sup>18</sup>

In 1926, the Board of Tax Appeals denied an exemption to a non-fraternal, mutual assessment, life and health insurance association. Though the organization had no capital stock outstanding and was not organized for profit,<sup>19</sup> the Board noted that "the express purpose [of the association was] to carry on the *business* of health and casualty insurance."<sup>20</sup> Although composed almost entirely of laborers and domestic servants, its membership was not so limited by its constitution; therefore the Board refused to treat the association as a labor organization.<sup>21</sup>

In 1939, the Board relied on its earlier newspaper ruling<sup>22</sup> to grant an exemption to a corporation which owned and operated an office building.<sup>23</sup> All the stock was owned by labor unions. Rates were set to equal expenses, but a small profit was earned. The building contained offices, all of which were leased by labor unions; a recreation hall, the use of which was restricted to members of the stockholder labor unions; and an auditorium and meeting halls, which were occasionally used by members of the public. The Board assumed without discussion that each participating union could have owned and operated the building and its facilities individually without losing its exemption, and then concluded that what each union could do alone it could do in cooperation with others through a corporate agency. A broad interpretation of "labor organization" was expounded:

The term has been used continuously for 30 years to bestow tax exemption, and it never has been found desirable by Congress to qualify it or by the administrator to give it a narrowing interpretation . . . . It bespeaks a liberal construction

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<sup>17</sup> S.M. 2558, III-2 CUM. BULL. 207-08 (1924).

<sup>18</sup> *Ibid.*

<sup>19</sup> Workingmen's Co-op. Ass'n of the United Ins. League, 3 B.T.A. 1352 (1926).

<sup>20</sup> *Id.* at 1354. (Emphasis added.)

<sup>21</sup> *Ibid.*

<sup>22</sup> See note 17 *supra* and accompanying text.

<sup>23</sup> Portland Co-op. Labor Temple Ass'n v. Commissioner, 39 B.T.A. 450 (1939).

to embrace the common acceptance of the term, including labor unions and councils and the groups which are ordinarily organized to protect and promote the interests of labor.<sup>24</sup>

Treasury Department Regulations interpreting the exemption provisions have continued essentially unchanged since 1929. The current Regulations, promulgated in 1958, read in part:

The organizations contemplated by section 501(c)(5) as entitled to exemption from income taxation are those which:

- (1) Have no net earnings inuring to the benefit of any member, and
- (2) Have as their objects the betterment of the conditions of those engaged in such pursuits, the improvement of the grade of their products, and the development of a higher degree of efficiency in their respective occupations.<sup>25</sup>

The 1958 Regulation departed from previous versions only in eliminating a requirement that section 501(c)(5) organizations be "educational or instructive in character."<sup>26</sup>

In 1959, the Treasury was asked to apply this regulation to a "committee [of employer and employee representatives] organized for the purpose of supervising the enforcement of apprenticeship standards in various skilled crafts. . . ." <sup>27</sup> The non-profit committee was supported primarily by contributions from employers and a union. The Treasury, relying on the object of the committee—to improve the lot of apprentices—ruled that it was exempt. This holding is consistent with the regulation insofar as it requires that the organization's object be the betterment of labor conditions. But the decision runs counter to the general rule of tax statute construction that in the absence of evidence to the contrary, Congress is presumed to have adopted the natural, ordinary, and familiar meaning of a term. The Treasury conceded that the term "labor organization" usually denotes a union solely of employees. In this instance, however, it felt that

the inclusion of such a committee in the term is warranted because of the fulfillment by the committee of the tests established for labor, agricultural and horticultural organizations and the further fact that the committee is similar in character to many of the organizations exempted from income taxation as agricultural or horticultural organizations under section 501(c)(5) of the Code.<sup>28</sup>

<sup>24</sup> *Id.* at 455.

<sup>25</sup> Treas. Reg. § 1.501(c)(5)-1(a) (1958).

<sup>26</sup> Compare Treas. Reg. § 39.101(1)-1 (1939).

<sup>27</sup> Rev. Rul. 59-6, 1959-1 CUM. BULL. 121, 122.

<sup>28</sup> *Id.* at 123.

In 1958, the Treasury had ruled that a union lost its exemption if it made death, sickness, or accident payments to individual members out of funds contributed by the general membership.<sup>29</sup> Because it believed that as a general rule the objectives of a labor organization must be the betterment of its membership as a group, the Treasury objected to the large element of personal benefit in such a plan.<sup>30</sup> This ruling was very recently overruled. The new ruling provides that if the plan "has as its object the betterment of the conditions of the members" the presence of individual benefit does not preclude exemption under 501(c)(5).<sup>31</sup>

Another aspect of the 1958 ruling, however, was not explicitly overruled. In dictum, the Treasury had indicated that it would have been proper for the labor organization to provide sickness, death, and similar benefits to its members as individuals, if the payments had not amounted to a substantial economic benefit to the members, and the fund used to provide them had been sufficiently small to warrant a finding that this activity was only an incidental function of the organization.<sup>32</sup> This statement can be characterized as a "major purpose" test. An otherwise exempt labor organization can conduct an activity which has no relation to the customary activities of a labor organization without losing its exemption, provided the activity is not a major purpose of the organization. This represents a major departure from earlier rulings and cases. Previously, the practice in conducting marginal activities had been to organize a distinct legal entity under the aegis of the tax-exempt labor organization. In that context, the Treasury or the courts were able to rule on the treatment of the questioned activity as such, without questioning the parent's tax status; if any activity was found to be without the scope of section 501(c)(5), the exemption was denied only to the satellite entity. Under the 1958 ruling, however, the parent itself can conduct such an activity, and, provided the activity is not major, retain its tax exemption, perhaps even as to the activity in question.<sup>33</sup>

Arguably all of the foregoing administrative and judicial interpretations of section 501(c)(5) and its predecessors can be read back into the Code on the theory that Regulations and interpretations long continued without substantive change applied to unamended or substantially reenacted statutes are deemed to have received congressional

<sup>29</sup> Rev. Rul. 58-143, 1958-1 CUM. BULL. 239, *overruled in part*, Rev. Rul. 62-17, 1962 INT. REV. BULL. No. 8, at 8.

<sup>30</sup> 1958-1 CUM. BULL. at 240.

<sup>31</sup> Rev. Rul. 62-17, 1962 INT. REV. BULL. No. 8, at 9.

<sup>32</sup> Rev. Rul. 58-143, 1958-1 CUM. BULL. 239, 240.

<sup>33</sup> *Ibid.*

approval and to have the force of law.<sup>34</sup> However, this canon of construction erroneously assumes that Congress in enacting the Code—a maze of conflicting policies<sup>35</sup>—was familiar with the Regulations, administrative rulings, and court decisions which construed and applied earlier tax statutes.<sup>36</sup> It would be an even greater step from reality to apply that presumption to a section such as 501(c)(5) which has been virtually ignored by Congress.

### C. Unrelated Business Income

Section 501(c)(5) exempts on an all-or-nothing basis. If all of a union's activities are within its scope, the provision, of course, encompasses them. But when a labor organization conducts an incidental nonexempt activity, the possibility arises that an otherwise taxable enterprise will become tax exempt by association. This tax shelter might give a union's nonexempt activity a competitive advantage over similar activities conducted by nonexempt organizations.<sup>37</sup>

Allegations of such competitive advantage were disregarded by the courts which held that feeder organizations—otherwise nonexempt business enterprises whose entire profits went to tax-exempt organizations—were themselves exempt. The most well-known example of the tax-exempt feeder was the C. F. Mueller Company, a major macaroni manufacturer. Its certificate of incorporation provided that it "is organized exclusively for charitable, scientific, literary, and/or educational purposes and no part of its income or property shall inure to the private benefit of any stockholder, director, or officer, or any individual or corporation other than New York University for the exclusive benefit of its school of Law."<sup>38</sup> All net income of the company was, in fact, paid to the University. The Tax Court, however, held that a competitive, commercial enterprise was not tax exempt simply because it was operated for the exclusive benefit of an organization that was. The Tax Court emphasized the adverse competitive effect of exempting a feeder organization. "[It] could have a vicious effect upon non-exempt competitors because the exempt organization, unlike the mere holding company, might be able to undersell its competitors as a result

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<sup>34</sup> See *Keystone Auto. Club v. Commissioner*, 181 F.2d 402, 405 (3d Cir. 1950); BITTKER, *FEDERAL INCOME ESTATE AND GIFT TAXATION* 28 (2d ed. 1961). See generally 6 MERTENS, *FEDERAL INCOME TAXATION* § 34.19 (rev. ed. 1957).

<sup>35</sup> See generally 1 MERTENS, *op. cit. supra* note 34, § 3.01.

<sup>36</sup> But see *McFeely v. Commissioner*, 296 U.S. 102 (1935).

<sup>37</sup> A tax free status gives two competitive advantages—ability to charge lower prices and ability to devote funds to reinvestment without first satisfying tax obligations.

<sup>38</sup> *C. F. Mueller Co. v. Commissioner*, 14 T.C. 922 (1950), *rev'd*, 190 F.2d 120 (3d Cir. 1951).

of the tax advantage and thus either drive them out of business or absorb them through its unlimited power to expand.”<sup>39</sup> The Court of Appeals for the Third Circuit, however, reversed on the ground that the purpose of the company, regardless of the nature of its activity, was solely to benefit a tax-exempt organization.<sup>40</sup>

The tax shelter possibilities of both the feeder subsidiary and the operating division were severely restricted when Congress in 1950, largely responding to the public furor over the *Mueller* case, enacted essentially what are now sections 502 and 511-14 of the Code.<sup>41</sup> Section 502 denies exemption to most feeder organizations. Sections 511-14 deal with unrelated business income of exempt organizations.

Section 511 imposes the normal corporate tax and surtax upon the unrelated business income<sup>42</sup> of exempt organizations. An unrelated trade or business is defined as one regularly carried on by an exempt organization, the conduct of which is not substantially related to the purposes for which the exemption is granted.<sup>43</sup> A trade or business in which “substantially all the work . . . is performed for the organization without compensation” is, however, expressly excluded from the definition.<sup>44</sup> Dividends,<sup>45</sup> interest,<sup>46</sup> royalties,<sup>47</sup> and capital gains<sup>48</sup> are similarly excepted. Rental income generally is not unrelated business taxable income, except for mortgaged property owned by an exempt organization and subject to a lease of five years or more.<sup>49</sup> Only that portion of rental income, however, which corresponds to the ratio of indebtedness on the building to the adjusted basis of the property is taxable.<sup>50</sup> Further, income from leases entered into primarily for purposes substantially related to the basic functions of an exempt organiza-

<sup>39</sup> *Id.* at 930.

<sup>40</sup> 190 F.2d 120 (3d Cir. 1951). Problems involving feeders have arisen in other contexts as well. In *Villyard v. Regents of University System of Georgia*, 204 Ga. 517, 50 S.E.2d 313 (1948), a local laundry, alleging unfair competition, sought but failed to enjoin a university-operated laundry from accepting business from families of those connected with the school. Several cases have questioned whether exempt organizations could, under their charters and state law, conduct certain unrelated activities. See Attorney General *ex rel.* *Sheehan v. Board of Educ.*, 175 Mich. 438, 141 N.W. 574 (1913); *State v. Southern Junior College*, 166 Tenn. 535, 64 S.W.2d 9 (1933); *Cook v. Chamberlain*, 199 Wisc. 42, 255 N.W. 141 (1929).

<sup>41</sup> Revenue Act of 1950, 64 Stat. 948 (now INT. REV. CODE OF 1954, §§ 502, 511-14).

<sup>42</sup> INT. REV. CODE OF 1954, § 512.

<sup>43</sup> INT. REV. CODE OF 1954, § 513(a).

<sup>44</sup> INT. REV. CODE OF 1954, § 513(a)(1).

<sup>45</sup> INT. REV. CODE OF 1954, § 512(b)(1).

<sup>46</sup> *Ibid.*

<sup>47</sup> INT. REV. CODE OF 1954, § 512(b)(2).

<sup>48</sup> INT. REV. CODE OF 1954, § 512(b)(5).

<sup>49</sup> INT. REV. CODE OF 1954, § 514.

<sup>50</sup> INT. REV. CODE OF 1954, § 514(c)(1).



tion is not included even if the lease is for a period greater than five years and the building is mortgaged.<sup>51</sup>

Revenue Ruling 59-330 is the only reported application of the 1950 amendments to a labor organization.<sup>52</sup> To meet maintenance expenses, a labor organization had conducted semi-weekly bingo games open to the general public. The Treasury ruled that the income therefrom was taxable under section 511 as unrelated business income. It held that the semi-weekly character of the games qualified them as regularly carried on, and that their sole function—the accrual of income to defray expenses—was not substantially related to the purpose of the union.

The application of the 1950 amendments to labor unions can perhaps best be illustrated by considering a hypothetical situation. Assume that a truck drivers' union operates a school to teach driver safety procedures. If substantially all of the instruction is conducted by union members without compensation, the school's profits are not taxable by reason of section 513(a)(1). Even if the labor organization hires and compensates professional instructors to operate the school, but restricts enrollment to union members, the profits thereof will be non-taxable because safety instruction aims to better drivers' working conditions, improve the quality of their product, and develop in them a higher degree of efficiency.<sup>53</sup> But if the school is open to members of the public, that part of the income derived from nonmember payments will be taxable as unrelated trade or business taxable income, because the sole relation of nonmember instruction to the union would be the accrual of income. Similar results would ensue if the school were operated as a feeder subsidiary rather than as an integral part of the union.<sup>54</sup> The Regulations to section 502, however, produce an anomalous result in one situation. If the school is owned jointly by several drivers' unions, its income is taxable, even though the instruction is given only to members of the parent labor unions.<sup>55</sup> This regulation is apparently based on the theory that since the income of a school operated by one union would be taxable if traceable to fees paid by members of another, a joint enterprise should be similarly treated. It should also be noted that the provisions in section 513(a)(1) which exempt a business in which substantially all of the work is done without compensation, do not apply to feeder subsidiaries.<sup>56</sup>

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<sup>51</sup> INT. REV. CODE OF 1954, § 514(b)(3)(A)(i). The same is true if the building is occupied by the organization. INT. REV. CODE OF 1954, § 514(b)(3)(A)(ii).

<sup>52</sup> 1959-2 CUM. BULL. 153.

<sup>53</sup> See Treas. Reg. § 1-501(c)(5)(a)(2) (1958).

<sup>54</sup> INT. REV. CODE OF 1954, § 502.

<sup>55</sup> Treas. Reg. § 1.502(b) (1950); *accord*, S.M. 2558, III-2 CUM. BULL. 207 (1924).

<sup>56</sup> INT. REV. CODE OF 1954, § 513(a)(1), which creates this exception, does not apply to § 502.

Although these provisions have probably eliminated the more obvious means of exploiting tax-exempt status,<sup>57</sup> the present statutory scheme still grants immunity to potentially major sources of union income. First, \$1000 of unrelated business taxable income is deductible.<sup>58</sup> Second, the requirement that an unrelated trade or business be carried on regularly<sup>59</sup> leaves open the possibility that an exempt organization can conduct an occasional unrelated activity at no tax cost. An occasional bingo game or raffle, which might yield great profits, would bear no tax since it would be considered nonregular. Third, the fact that income, however large, from activities performed gratuitously by members of a labor organization is not taxable<sup>60</sup> provides an obvious way to evade the unrelated trade or business tax. Finally, the most significant exemption of income is the provision excepting dividends, interest, rents, royalties, and capital gains received from the operation of an unrelated trade or business.<sup>61</sup>

#### D. Related Statutory Provisions

Employee benefit plans<sup>62</sup> constitute a type of labor organization which conceivably could qualify under section 501(c)(5) for tax-exempt status but for the applicability of other subsections. Ordinarily, these "welfare plans" are operated entirely apart from the labor unions with which they are affiliated. Among the benefits they provide are pensions, health insurance, and supplemental unemployment payments. Virtually all of these are negotiated by collective bargaining either on a company or industry-wide basis. The plans are generally financed by contributions from the employer in lieu of wages,<sup>63</sup> although employees occasionally contribute directly. Some unions operate their own funds from members' dues or special assessments. Most are administered by

<sup>57</sup> Substantial problems remain in interpreting and applying these provisions, particularly in delimiting "related" activities. See Note, 34 NOTRE DAME LAW. 238 (1959); 60 YALE L.J. 851, 854 (1951).

<sup>58</sup> INT. REV. CODE OF 1954, § 512(b)(12).

<sup>59</sup> INT. REV. CODE OF 1954, § 512(a).

<sup>60</sup> INT. REV. CODE OF 1954, § 513(a)(1).

<sup>61</sup> INT. REV. CODE OF 1954, § 512(b). Several congressional committees characterized such income as "passive." Congress appears to have felt that such income was insubstantial and derived from such sources as to have no detrimental effects on the investment market. See H.R. REP. No. 2319, 81st Cong., 2d Sess. 38 (1950).

<sup>62</sup> These funds have mushroomed in the last 15 years to the point where their total resources stagger the imagination. Best estimates are that the combined assets of pension and welfare funds of all unions approximate \$50,000,000,000 at the present time, with contributions exceeding payments at the rate of 4 to 5 billion dollars annually. See N.Y. Times, Jan. 2, 1961, p. 10, cols. 1-2; *id.*, Feb. 25, 1961, p. 6, col. 1; Levitan, *Welfare and Pension Plans Disclosure Act*, 9 LAB. L.J. 827, 828 (1958). This amounts to approximately twice the total assets of this country's largest corporate enterprise. See 1961 AMERICAN TEL. & TEL. CO. ANN. REP. 26.

<sup>63</sup> These fringe benefits cost American business \$18,000,000,000 in 1960, 7.4% of total labor costs. See N.Y. Times, Jan. 9, 1961, p. 61, col. 1.

independent trustees selected by management, but some also have union representatives.<sup>64</sup>

The Code treats employee benefit plans in three general categories. The first consists of pension plans, which are further subdivided into trust funds,<sup>65</sup> organized in legal form, and insurance plans<sup>66</sup>—life insurance policies taken by the employer to cover his employees. The tax results are similar.<sup>67</sup> If a pension trust does not discriminate in favor of executives or highly compensated employees and cannot be used for any purpose other than employee compensation, it qualifies under section 401 for exemption of its investment income pursuant to section 501(a). In one case, a section 401 pension trust was taxed on rental income from railroad tank cars which it had purchased and leased even though the trustee's only duty was to receive the money, while the lessee handled maintenance and operation. The Treasury ruled that this was a regularly carried-on business having no relation to the purpose of the trust other than as a source of revenue.<sup>68</sup> Pension trusts can also lose their entire exemption if they engage in specified prohibited transactions which substantially divert income or corpus to the trust creator, a substantial contributor thereto, or an affiliate thereof.<sup>69</sup> If the trust fund organizes a feeder organization, the entire proceeds of which go to the trust, or if the trust itself engages in an unrelated business activity, the resulting income is subject to tax.<sup>70</sup>

The second category of welfare plans consists of voluntary employers' associations which provide sickness, accident, hospital, and similar benefits. They are tax exempt pursuant to section 501(c)(9), provided that no part of the association's net earnings other than benefit payments inures to the benefit of any individual, and that at least 85% of the association's net income is contributed by employers and employees. These associations are subject to the feeder organization

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<sup>64</sup> One observer has stated that labor is pressing for a more active role in the conduct of funds now under employer command. This will mean more union money invested in housing for low and middle income families, community facilities, and corporate securities. This latter development raises the problem that unions may someday obtain a dominant role in the ownership of many large companies, thus occupying both sides of a collective bargaining table. See Raskin, *The Unions and Their Wealth*, The Atlantic, April 1962, pp. 87-88.

<sup>65</sup> INT. REV. CODE OF 1954, §§ 401-04.

<sup>66</sup> INT. REV. CODE OF 1954, §§ 804-05.

<sup>67</sup> Capital gains, accumulated in reserves by life insurance companies for qualified pension and profit sharing plans, are fully tax exempt. Basically, all income of life insurance companies is divided into two parts—the policyholder's share, which is exempt; and the company's share, which is taxable. INT. REV. CODE OF 1954, § 804. Pension Plan Reserves, as defined by INT. REV. CODE OF 1954, § 805(a)(2) and Treas. Reg. 1.805-7 (1960), are included in the policyholder's portion, and amounts credited to them in the company's current earnings are exempt from tax. Life Insurance Company Income Tax Act of 1959, 73 Stat. 112, 26 U.S.C.A. §§ 801-20 (Supp. 1961).

<sup>68</sup> Rev. Rul. 60-206, 1960-1 CUM. BULL. 201.

<sup>69</sup> INT. REV. CODE OF 1954, § 503(c).

<sup>70</sup> INT. REV. CODE OF 1954, §§ 502, 511.

rule, but not to the unrelated business income provision. While the prohibited transaction restriction applied to pension trusts does not pertain to section 501(c)(9) associations,<sup>71</sup> the stringent requirements for qualification under that section eliminate the need for these limitations.

To avoid the requirement that 85% of the income of a 501(c)(9) association derive from employer-employee contributions, a third type of plan came into use. Supplemental unemployment benefit plans, although not new, were not utilized on a broad scale until 1955 when the United Auto Workers included such a plan in its contract with the auto manufacturers. These plans, designed to add to state unemployment compensation payments by providing 60% of straight-time take home pay,<sup>72</sup> were originally granted exemption under section 501(c)(9) by analogy to health and accident plans.<sup>73</sup> Similar plans were subsequently adopted in other industries.<sup>74</sup> However, difficulty arose when many plans found that their revenue from investment and other sources exceeded 15% of their total income. At that point, Congress enacted section 501(c)(17), explicitly exempting trusts designed to provide supplemental unemployment compensation, regardless of the source of their income, so long as they meet the tests of nondiscrimination applied to pension trusts.<sup>75</sup>

## II. THE MODERN LABOR UNION AS A SECTION 501(c)(5) LABOR ORGANIZATION

Labor's tax exemption originated without congressional deliberation; it continues to exist without reexamination despite vast changes in the labor movement which at least pose the question of whether favored treatment is still warranted. The regulations which define qualifying agricultural, labor, and horticultural organizations hardly take cognizance of these changes. The narrow list of legitimate objectives of such organizations, if construed as setting the outer limits of permissible activity, might well exclude most modern labor unions.<sup>76</sup> The exemption appears to have survived only by virtue of the acquiescence by Congress and the Treasury Department in the new content which changing times have given to the term "labor organization."<sup>77</sup>

<sup>71</sup> INT. REV. CODE OF 1954, § 503(a)(2).

<sup>72</sup> See Rev. Rul. 56-102, 1956-1 CUM. BULL. 90. Special provisions are made for the rare cases which do not qualify for state aid.

<sup>73</sup> Rev. Rul. 58-442, 1958-2 CUM. BULL. 194.

<sup>74</sup> See Rev. Rul. 57-37, 1957-1 CUM. BULL. 18.

<sup>75</sup> Congress felt that these funds were non-profit in character, provided worthwhile benefits, and did not compete with profit making enterprises. H.R. REP. NO. 1145, 86th Cong., 1st Sess. 5 (1959).

<sup>76</sup> See note 51 *supra* and accompanying text.

<sup>77</sup> See note 32 *supra* and accompanying text.

This theory of implied congressional approval can, however, be buttressed by an argument based on statutory construction. The modern labor union may be entitled to tax-exempt status as a "labor organization" because it possesses the principal attributes of other organizations granted exemptions under section 501(c). While this section was neither conceived nor adopted as a unified whole, since each of its seventeen subsections and thirty-five classifications has its own legislative history and policy<sup>78</sup> a general pattern is nonetheless discernible.

First, all tax-exempt organizations are non-profit. This fundamental prerequisite has received little critical examination by the courts or commentators and is usually taken for granted. It is explicitly provided for some organizations in the Code or the Regulations by the phrase "not organized for profit and no part of the net earnings of which inures to the benefit of any private shareholder."<sup>79</sup> As to the other exempt groups, it is implicit. This does not mean, however, that a non-profit organization's revenue may never exceed its disbursements. But if the organization does have an excess of revenue over expenditures it may not distribute it to members as dividends or similar payments; all income must be used to provide the benefits for which the exemption is granted. Labor unions qualify under this standard.<sup>80</sup>

Second, exempt organizations formed primarily to advance a group interest may not provide more than minimal benefits to non-members.<sup>81</sup> Thus a social club which opened its doors to the public lost its exemption.<sup>82</sup> Except insofar as nonunion employees benefit from union negotiated contracts, labor unions rarely provide direct services to nonmembers and would, therefore, appear to comply with this limitation.

Third, exempt organizations can be classified into two general categories on the basis of the benefits they render. One group consists

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<sup>78</sup> See generally Sugarman & Pomeroy, *Business Income of Exempt Organizations*, 46 VA. L. REV. 424 (1960).

<sup>79</sup> See, e.g., INT. REV. CODE OF 1954, §§ 501(c) (6)-(7).

<sup>80</sup> See *West Laurel Hill Cemetery Co. v. Rothensies*, 139 F.2d 50, 56 (3d Cir. 1943).

<sup>81</sup> Dealings with the public must be only incidental or the cooperative and non-profit features would be destroyed. In theory, these organizations collect funds only from members and later distribute other funds, products, or services of an equal value back to the contributors, presumably at cost. No profit is made. Furthermore, a non-profit organization may not derive "profits from outside sources wholly disproportionate to its nontaxable purposes, and [if] such profits inure to the benefit of its members in the nature of permanent improvements and facilities, it loses its exempt status. . . ." *Aviation Club v. Commissioner*, 162 F.2d 984, 986 (10th Cir. 1947).

<sup>82</sup> *Treas. Reg. § 1.501(c) (7)-1* (1958). See also *Town & Country Club*, 11 P-H Tax Ct. Mem. 1731 (1942).

of those organizations which primarily benefit the general public, while the other contains those which benefit their own members.

The first group, which may be termed "public welfare" organizations, is covered by only two of section 501(c)'s seventeen subsections; but it encompasses the largest and best known of exempt organizations. Included in this category are non-profit corporations, community chests, funds or foundations which are operated exclusively for religious, charitable, scientific, public safety, literary or educational purposes, or for the prevention of cruelty to children and animals,<sup>83</sup> civic leagues operated exclusively for the promotion of social welfare, and local employee associations devoted wholly to charitable or educational purposes.<sup>84</sup>

The second set of organizations, those which primarily benefit their own members or contributors, can be further subdivided into member job-oriented organizations, which enhance the individual's economic position, and member welfare-oriented organizations which promote personal well being. Groups of persons with a common business interest organized essentially to increase individual earning capacity include agricultural and horticultural organizations,<sup>85</sup> business leagues, chambers of commerce, real estate boards, boards of trade,<sup>86</sup> mutual ditch, irrigation, telephone, and insurance companies,<sup>87</sup> credit unions,<sup>88</sup> limited purpose non-stock financial institutions providing reserves for liability, and banking associations whose profits are shared by their members.<sup>89</sup> Organizations devoted largely to the personal welfare of their members include employee associations<sup>90</sup> and fraternal lodges which provide sickness, accident, and health benefits;<sup>91</sup> supplemental unemployment trusts,<sup>92</sup> clubs<sup>93</sup> and local employee or community associations<sup>94</sup> devoted to recreation, pleasure, or other non-profitable pur-

<sup>83</sup> INT. REV. CODE OF 1954, § 501(c) (3).

<sup>84</sup> INT. REV. CODE OF 1954, §§ 501(c) (4)-(5). See also INT. REV. CODE OF 1954, § 501(c) (16).

<sup>85</sup> INT. REV. CODE OF 1954, § 501(c) (5). See also INT. REV. CODE OF 1954, § 501(c) (16).

<sup>86</sup> INT. REV. CODE OF 1954, § 501(c) (6).

<sup>87</sup> INT. REV. CODE OF 1954, § 501(c) (14).

<sup>88</sup> *Ibid.*

<sup>89</sup> *Ibid.*

<sup>90</sup> INT. REV. CODE OF 1954, §§ 501(c) (9)-(10).

<sup>91</sup> INT. REV. CODE OF 1954, § 501(c) (8).

<sup>92</sup> INT. REV. CODE OF 1954, § 501(c) (17).

<sup>93</sup> INT. REV. CODE OF 1954, § 501(c) (7).

<sup>94</sup> INT. REV. CODE OF 1954, § 501(c) (4).

poses, local teachers' retirement funds,<sup>95</sup> mutual cemetery companies,<sup>96</sup> and local benevolent life insurance companies.<sup>97</sup>

Judged by the nature of the benefits they provide, labor unions again qualify for tax exemption. Today's unions engage in public welfare programs, are member job-oriented, and provide for the individual well being of their members.

The most significant benefits provided by the modern labor union are job related. As the agent for collective bargaining, the union negotiates with the employer concerning wages and general working conditions, represents its members in grievance proceedings, and enforces discipline.<sup>98</sup> In addition, it maintains strike benefit funds,<sup>99</sup> sponsors vocational classes,<sup>100</sup> publishes labor newspapers, builds and operates labor buildings for meetings and social and recreational purposes, and conducts public relations and advertising campaigns.<sup>101</sup> In general these are the traditional benefits of the labor union, and those which probably prompted the original tax exemption in 1909.

In recent times unions have come to devote more time, effort, and money to promoting the personal welfare of their members as well. This concern is most obvious in three areas—health, housing, and retirement. Unions are making increased efforts to safeguard the health of their members and their families. They are also concerned with offsetting the high cost of medical services. Some unions are setting up cooperative health plans,<sup>102</sup> health insurance funds,<sup>103</sup> prepaid drug prescription plans,<sup>104</sup> health resorts, hospitals,<sup>105</sup> and clinics.<sup>106</sup> The high

<sup>95</sup> INT. REV. CODE OF 1954, § 501(c)(11).

<sup>96</sup> INT. REV. CODE OF 1954, § 501(c)(13).

<sup>97</sup> INT. REV. CODE OF 1954, § 501(c)(12).

<sup>98</sup> A noted commentator has stated that the greatest union benefits have been in the realm of "nonpecuniary concessions" such as protecting the employee from arbitrary or discriminatory action by employers by use of grievance procedures, seniority requirements, racial bans, etc. Their actual economic benefits have been modest. Chamberlain, *The Corporation and the Trade Union*, in *THE CORPORATION IN MODERN SOCIETY* 133 (Mason ed. 1960).

<sup>99</sup> For some unions, strike benefits can be a major expenditure. In 1959 alone, the United Auto Workers paid its members \$12,600,000 for this purpose. An additional \$6,000,000 was paid during their brief walkout against the Big Three during 1961. In 1959, strikes cost the steel workers \$6,300,000, the machinists \$4,400,000, and the Teamsters \$1,100,000. *Business Week*, June 4, 1960, pp. 83-84. These funds not only provide subsistence for the strikers; they create a powerful psychological weapon for use in collective bargaining.

<sup>100</sup> See *Business Week*, June 4, 1960, pp. 83-84. The United Steel Workers recently announced that it will provide adult education classes to combat hard core unemployment, with government assistance under the Manpower Development & Retraining Act of 1962. *Wall Street Journal*, May 17, 1962, p. 2, cols. 3-4.

<sup>101</sup> See Raskin, *The Unions and Their Wealth*, *The Atlantic*, April 1962, pp. 94-95.

<sup>102</sup> See *N.Y. Times*, June 28, 1961, p. 37, col. 8.

<sup>103</sup> See *N.Y. Times*, May 7, 1961, p. 132, col. 3.

<sup>104</sup> See *N.Y. Times*, July 7, 1961, p. 27, col. 1.

<sup>105</sup> See *N.Y. Times*, April 16, 1961, p. 44, col. 1.

<sup>106</sup> See *N.Y. Times*, June 3, 1961, p. 46, cols. 6-7.

cost of housing has prompted unions to invest an increasingly higher percentage of their treasuries and related pension and welfare plan funds in housing developments.<sup>107</sup> Unions are also broadening the coverage of their pension and welfare programs, and some have built or constructed hotels for their retired members.<sup>108</sup> Other non-job-oriented benefits include scholarship programs for members' children, free legal advice, civil rights projects,<sup>109</sup> citizenship courses, consumer cooperatives, and recreational and social activities.

A small but expanding part of the benefits provided by labor unions also accrue to the community as a whole. Labor organizations sponsor world wide propaganda activities stressing the benefits of free labor,<sup>110</sup> donate large sums of money and services to various charities,<sup>111</sup> bring foreign workers here for job training,<sup>112</sup> contribute funds to promote unionization abroad,<sup>113</sup> and provide jobs for foreign students on vacation.<sup>114</sup> They have recruited men to help build the Distant Early Warning radar line in Canada and projects for the Peace Corps,<sup>115</sup> and have solicited "no strike" pledges from men working on missile sites.

The range of activities undertaken by modern labor unions thus provides an even stronger basis for their inclusion as a tax-exempt organization than existed in 1909 when unions were largely preoccupied with job oriented benefits.<sup>116</sup> If the union tax exemption is to be re-

<sup>107</sup> See N.Y. Times, June 23, 1961, p. 18, col. 2.

<sup>108</sup> Ten unions have joined together to purchase a two hundred and five room ocean front hotel in the heart of Miami Beach to be operated as a non-profit, residential hotel for retired members. The group plans to buy four more hotels in other cities. N.Y. Times, March 26, 1961, § 10, p. 3, cols. 1-5.

<sup>109</sup> In 1959, the United Auto Workers devoted \$126,195 to achieving fair practices and eliminating discrimination. U.S. News & World Report, April 25, 1960, p. 47.

<sup>110</sup> See LERNER, AMERICA AS A CIVILIZATION 327 (1957).

<sup>111</sup> The AFL-CIO recently gave \$1,000,000 to the Eleanor Roosevelt Cancer Foundation. N.Y. Times, Feb. 24, 1961, p. 58, col. 1. The International Ladies Garment Workers' Union and its affiliates have given \$33,000,000 to charitable and philanthropic causes since 1940 and \$5,200,000 in the last three years. See N.Y. Times, May 28, 1962, p. 25, col. 1.

<sup>112</sup> See N.Y. Times, May 7, 1961, p. 76, col. 3.

<sup>113</sup> The AFL-CIO has initiated a campaign to raise funds to aid the Algerian labor movement. N.Y. Times, May 29, 1962, p. 1, col. 5.

<sup>114</sup> See N.Y. Times, June 8, 1961, p. 19, col. 3.

<sup>115</sup> See N.Y. Times, April 1, 1961, p. 1, col. 1.

<sup>116</sup> Not all job-related activities warrant tax exemption. Union actions which constitute part of a joint employer-employee scheme to gain market control can logically be categorized as job related. These actions, however, are denied the immunity from the antitrust laws which labor generally enjoys. See ATT'Y GEN. NAT'L COMM. ANTITRUST REP. 293-306 (1955); Brickner, *The Apex Decision: A New Look at Unions Under Antitrust Actions*, 11 LAB. L.J. 155 (1960); Daykin, *Status of Unions Under Our Antitrust Laws*, 11 LAB. L.J. 216, 223 (1960).



tained, the Regulations promulgated pursuant to section 501 (c) (5) should be updated to acknowledge explicitly the legitimacy of many union activities which have long been tacitly accepted.

### III. A REAPPRAISAL OF SECTION 501(c)(5) AND LABOR'S ROLE IN MODERN SOCIETY

As we have tried to demonstrate, the labor organization exemption was written into the Internal Revenue Code and has been administratively and judicially applied without any comprehensive consideration of the interests at stake. In light of recent expansions in union power, wealth, and activity, the implications of this substantial tax advantage on labor's influence in modern society should be re-examined.<sup>117</sup>

Although several smaller unions are facing acute problems of declining membership and increased unemployment by reason of expanded automation,<sup>118</sup> the majority of labor unions today are vastly stronger financially than they were fifty years ago when they first were granted the tax exemption.<sup>119</sup> On June 14, 1962, then Labor Secretary Goldberg announced that assets of the nation's labor unions, based on 1960 financial reports submitted pursuant to the Landrum-Griffin Act, exceed \$1,300,000,000.<sup>120</sup>

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<sup>117</sup> The problem of molding the modern labor union to the public interest has intrigued many scholars. See, e.g., Form, *Organized Labor's Place in the Community Power Structure*, 12 IND. & LAB. REL. REV. 526 (1959); Goldberg, *The Role of the Labor Union in an Age of Bigness*, 55 NW. U.L. REV. 54 (1960); Pendleton, *Responsibility of Labor Unions in a Private Enterprise Economy*, 10 LAB. L.J. 539 (1959).

<sup>118</sup> See Raskin, *The Unions and Their Wealth*, The Atlantic, April 1962, p. 87. Union membership in the United States has shown a constant decline in the past few years. In 1960, there were 17,000,000 union members, 68,000 fewer than in 1959 and 341,000 fewer than in 1956. N.Y. Times, Nov. 25, 1961, p. 46, col. 6. See also Fortune, April 1957, pp. 233-34. Union membership should continue to decline in the future. See Lester, *The Changing Nature of the Union*, N.Y.U. 13TH ANNUAL CONFERENCE ON LABOR 29 (1960). Furthermore, rising costs plus steady unemployment have cut dues revenue and forced increased benefit payments. It is no wonder, then, that close to one-half of the organizations submitting Landrum-Griffin reports operated in the red during the recession year of 1959. Business Week, June 4, 1960, pp. 83-84.

<sup>119</sup> One of the country's most affluent unions, the ILGWU, recently reported liquid assets in its treasury of \$76,600,000 which in 1961 earned \$1,500,000. Adding its solely administered and jointly administered employee benefit funds gives the ILGWU \$424,000,000. N.Y. Times, May 28, 1962, p. 25, col. 1. See Raskin, *The Unions and Their Wealth*, The Atlantic, April 1962, p. 87. There is, however, a wide divergence in size and strength, financial and otherwise, among various unions, industries, and even sections of the country. See Cox, *The Uses and Abuses of Union Power*, 35 NOTRE DAME LAW. 624, 628 (1960). In 1959, 25% of 260 national unions had total receipts of more than \$1,000,000 while 16% had receipts far less than \$10,000. N.Y. Times, June 15, 1962, p. 12, col. 1.

<sup>120</sup> N.Y. Times, June 15, 1962, p. 12, col. 1. These figures are taken from Landrum-Griffin reports for fiscal 1959 and are thus the first comprehensive economic reports ever available on American unions, which traditionally have been reluctant to disclose their financial affairs. These figures are exclusive of welfare and pension funds; nor are income and assets of local and regional groups included in the statistics for the affiliated nationals. The International Brotherhood of Electrical Workers,

Labor's new affluence most crucially affects its relations with management. The fundamental assumption underlying American labor policy has been that a labor agreement achieved by a process of unhindered negotiation between equals would be best for labor, management, and the economy as a whole. Originally, the labor union tax exemption may have served to further the realization of countervailing power. By affording unions a measure of financial assistance, however indirect, the exemption enabled them to overcome their previously inferior position and, thus, to adopt a more useful role in society. But the time has come to question whether the exemption has not fulfilled its task in this regard. Continued financial aid of this nature may produce an imbalance of strength in favor of labor, inimical to the very ideal of collective bargaining between equals which it once fostered.<sup>121</sup>

Increasing union wealth may have yet another deleterious effect on the collective bargaining process. To date, labor unions have made no appreciable investment in corporate securities.<sup>122</sup> Should they employ their tax-immune funds for such purchases in the future,<sup>123</sup> management's position may be further weakened. If a union owned a sig-

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the nation's wealthiest union, had assets of \$111,311,000 and yearly receipts of about \$65,000,000. The United Mine Workers' assets exceeded \$110,000,000, while the receipts of the United Steelworkers and United Auto Workers in 1959 were \$62,000,000 and \$42,000,000 respectively. N.Y. Times, June 15, 1962, p. 12, col. 1.

<sup>121</sup> The recent discussions of labor's power fail to frame the issues in terms of the size of a union's economic resources. See, e.g., *Symposium on Union Power and the Public Interest*, 35 NOTRE DAME LAW. 590 (1960); Chamberlain, *Labor Union Power and the Public Interest*, in *THE PUBLIC STAKE IN UNION POWER* (1959); KUHN, *LABOR INSTITUTIONS AND ECONOMICS* 127 (1959); LINDBLOM, *UNIONS AND CAPITALISM* (1949).

<sup>122</sup> This refers to treasuries and other funds directly controlled by unions; this does not include pension, health, and other welfare funds, most of which are independently administered, and many of which have bought substantial amounts of corporate securities.

<sup>123</sup> There is a decided trend today toward liberalization of union investment policies. For example, in 1953, one observer found that 42 internationals had put 73% of their money into bonds (mostly 2.75% governments), 5% into mortgages, 3.4% into real estate, and had retained 11% in cash. Only 1.6% of the reserves had been invested in equities and that figure was inflated by one union which poured 70% of its assets into the stock market, realizing a 6% return. Belfer, *Trade Union Investment Policies*, 6 IND. & LAB. REL. REV. 337, 339 (1953). As late as 1957, Fortune magazine concluded that "union investment policies remain extremely conservative." It did note that the Teamsters and the International Brotherhood of Electrical Workers were now putting some money into FHA-backed mortgages. Fortune, April 1957, p. 239. But recently, the evidence has mounted that unions are placing more funds in such relatively lucrative sources as housing mortgages and corporate equities. See N.Y. Times, Feb. 22, 1961, p. 1, col. 2. For instance, the Electrical Workers Pension Fund has put half of its \$61,000,000 backlog into real estate mortgages and one-third into corporate stocks and bonds. U.S. News and World Report, Sept. 6, 1957, p. 114. In the past four years the ILGWU has invested one-third of its total resources in Government-backed housing mortgages and an additional 11% in corporate bonds. N.Y. Times, Jan. 2, 1961, p. 10, cols. 1-2. That union also recently announced its intention to invest \$100,000,000 of its pension funds in government insured farm loans. N.Y. Times, April 28, 1962, p. 12, col. 3. The AFL-CIO has inaugurated a new Department of Investment at its Washington headquarters to counsel its 132 affiliates on investment matters.

nificant proportion of an employer's common stock,<sup>124</sup> that employer as a collective bargainer, might be compelled to seek a settlement favorable to its stockholder employees rather than one which would serve the best interests of its suppliers, customers, or other stockholders.<sup>125</sup>

A modest undercurrent of public opinion is developing to the effect that some labor unions are overstepping the bounds of permissible behavior.<sup>126</sup> Much of this feeling may be traceable to the economic ability of unions to strike for benefits which are not in the public interest.<sup>127</sup> Most unions now maintain huge reserves for use in the event of a strike.<sup>128</sup> These funds are at least partly generated by the benevolence of our tax policy. To the extent that this benevolence assists strikes which are contrary to the public interest, continued tax exemption may be undesirable.<sup>129</sup> Whether the danger point has already been reached is unclear, but the possibility that union wealth will continue to grow rapidly under the present tax structure necessitates extremely sensitive scrutiny. Also, to the extent that the tax exemption further unbalances the collective bargaining process, it augurs more governmental intervention to protect the public interest, a development which would be viewed by many with disfavor.

The possibility that labor unions might use part of their increasing wealth to purchase corporate securities raises additional dangers unrelated to the collective bargaining arena.<sup>130</sup> Our economy is theoretically based on the assumption that the profit motive, if allowed

<sup>124</sup> The same reasoning would apply, to a lesser degree, if a union purchased large amounts of stock in companies other than its employer.

<sup>125</sup> To date, union leaders themselves have been strongly opposed to sitting on both sides of the bargaining table. See Raskin, *The Unions and Their Wealth*, The Atlantic, April 1962, p. 87.

<sup>126</sup> See, e.g., S. REP. NO. 1417, 85th Cong., 2d Sess. (1958); Remarks by Sen. Goldwater, quoted in N.Y. Times, Aug. 9, 1962, p. 15, col. 1; EELLS, *THE MEANING OF MODERN BUSINESS* 239 (1960); EELLS & WALTON, *CONCEPTUAL FOUNDATIONS OF BUSINESS* 120 (1961); KENNEDY, *THE ENEMY WITHIN* (1960); PETRO, *THE LABOR POLICY OF THE FREE SOCIETY* (1957); PETRO, *POWER UNLIMITED: THE CORRUPTION OF UNION LEADERSHIP*, at v-vi (1959); Chamberlain, *The Problem of Strikes*, N.Y.U. 13TH ANNUAL CONFERENCE ON LABOR 421 (1960); Rees, *Do Unions Cause Inflation?*, 2 J.L. & ECON. 84 (1959); Rothenberg, *National Emergency Disputes*, 12 LAB. L.J. 108 (1961); Note, *Racial Discrimination in Union Membership*, 13 U. MIAMI L. REV. 364 (1959).

<sup>127</sup> To cure these problems, many commentators have suggested changes in the collective bargaining system to include such procedures as compulsory arbitration. See Rothenberg, *National Emergency Disputes*, 12 LAB. L.J. 108, 137 (1961); N.Y. Times, July 29, 1962, § IV, p. 9, col. 2.

<sup>128</sup> See note 99 *supra*. The UAW presently possesses a strike fund of \$40,434,109 and total resources of \$60,298,499. N.Y. Times, May 6, 1962, p. 1, col. 2.

<sup>129</sup> It should be pointed out, however, that in 1961, time lost through work stoppages reached a postwar low of 0.14% of total working time. N.Y. Times, July 29, 1962, § IV, p. 9, col. 1.

<sup>130</sup> The financial dealings of unions today are not always antagonistic to those of management. The Amalgamated Clothing Workers recently contributed money to the American Institute of Men's and Boy's Wear, a trade association, for industrial promotion. The Advance, March 15, 1962, p. 1, col. 1.

to operate freely, will maximize industrial benefits. But if management, in arriving at its decision, must heed the wishes of stockholder employees, it might be forced to depart from the goal of profit maximization. Thus, such a management's equipment policy might sacrifice efficiency to avoid unemployment incident to automation. Insofar as the labor tax exemption leads to managerial disregard of the profit motive, it represents yet another encroachment on the ideal of a free enterprise system.

Unions owning corporate securities might further press for increased dividend payments at the expense of capital retention, since the dividends, under the current tax code, are not taxable to the unions. A decreased availability of internally generated funds, coupled with the present high rates of borrowed capital, might reduce the rate of corporate expansion, a result at odds with current desires to accelerate the growth of the Gross National Product. On the other hand, it is equally possible that unions might favor capital retention at the expense of dividends, if increased capital investment would mean additional jobs for their members. In either event, dividend policy would no longer be guided by normal business considerations.

In addition to compromising management's independence, union ownership of an employer's securities might subject union leadership to conflicts of interest. To the extent that a union has invested heavily in an enterprise, its leaders might subordinate the short run aims of its members to the protection of its investment, which may or may not be in the long run interest of the employees. For example, a union which has an equity interest in a company might well soften its wage and other demands in an effort to stabilize or better the financial status of the company.

Although unions have not significantly invested in corporate securities up to now, their investment in such relatively lucrative sources as housing mortgages<sup>131</sup> points up another weakness of section 501(c)(5). The competitive advantage enjoyed by tax-exempt unions may unfairly cripple taxpaying investors and money lenders.<sup>132</sup> The unrelated business income provisions, inspired by the fear of unfair competitive advantage, might well be applied to investments too, now that unions compete with regular financial institutions. There are, of course, two obvious strategies which unions can undertake to dissuade

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<sup>131</sup> See notes 101-02 *supra* and accompanying text.

<sup>132</sup> The Amalgamated Clothing Workers owns and operates two banks with combined assets, as of December 31, 1961, of more than \$150,000,000. These banks charge lower interest rates than competing commercial banks, and the union claims that the existence of these lower rates prevents commercial banks from raising their rates even higher. The Advance, March 15, 1962, pp. 8-9. If this is true, the tax-exempt status of unions may provide unexpected benefits to the public.

congressional adoption of more stringent provisions dealing with investment sources of income. First, they might seek investments which do not bring them into direct competition with banking institutions and insurance companies. Second, unions might enlist congressional support by investing in projects which involve some aspect of social welfare. An example, illustrative of both strategies, would be union investment in low income housing and FHA-insured mortgages in urban renewal areas.<sup>133</sup> In view of the reluctance of traditional lending institutions to extend credit to minority groups, unions could invest profitably with FHA protection, fill a critical investment need, and avoid competition with other investors.

Finally, increased union affluence may have a detrimental effect on the structure of the labor movement itself. If wealthy unions should purchase substantial quantities of corporate securities, they would be in a position to increase job opportunities for their members at the expense of members of unions less able to secure a voice in corporate management. This could foster a more centralized labor movement as the wealthier unions eliminate their weaker rivals. A greater concentration of union power and wealth, in turn, would produce an even greater imbalance in the collective bargaining equation.<sup>134</sup>

#### IV. SECTION 501(c)(5) AS AN INSTRUMENT OF SOCIAL CONTROL

With a continuation of labor's present tax status, union financial strength may reach increasingly dangerous proportions. Whether labor's present financial power—in part achieved by the benevolence of the tax code—warrants intervention in the form of amendment or possible elimination of the tax exemption is still unclear.<sup>135</sup> If and when the danger point is reached, however, the advisability of revising the present tax policy should be raised.<sup>136</sup>

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<sup>133</sup> If a union enters home financing on a large scale, as many have publicly said they will, the Internal Revenue Service could claim that it had entered the home financing business, an unrelated activity to which sections 511-13 of the Code would apply. Although this might end the resulting unfair competition between unions and regular financial institutions, such a step seems highly unlikely as a matter of administrative policy.

<sup>134</sup> Some groups are already taking steps to correct what they feel is an unfair balance in labor's favor. Several groups of investors have formed shareholder "unions" to counteract the political and economic influence of labor organizations. These groups, including United Shareholders of America, Stockholders and Shareholders, Inc., Investors Union of America, and The Investors' League, have adopted a program calling for an end to management's surrendering to inflationary wage demands. See N.Y. Post, July 30, 1962, p. 32, col. 3.

<sup>135</sup> Labor's political importance makes congressional consideration of the advisability of eliminating or revising the exemption highly unlikely. Public opinion and the general political climate must undergo substantial change before any likelihood of modification in labor's tax exemption can arise.

<sup>136</sup> One authority, stressing that only employers and public opinion can control inflationary problems relating to collective bargaining, has stated that tax law and public policy can do little in this regard. Slichter, *New Gods for Unions*, in *SELECTED ESSAYS OF SUMNER A. SLICHTER* 291 (1960).

Congress has, in some circumstances, balked at applying pressure for social reform in this manner. It has refused, for example, to utilize the taxing power to combat the problem of union corruption. Legislation recommended by President Eisenhower would have empowered the Secretary of Labor to investigate violations of the labor laws pertaining to malpractice, corruption, and election rigging; to hold administrative hearings, and issue final corrective orders subject to judicial review. Included among the possible sanctions the Labor Secretary could impose was loss of tax exemption. Secretary Mitchell, in committee hearings in both Houses of Congress, supported the provision as an effective deterrent to corruption "when all else in the way of union members' self-help has failed."<sup>137</sup> The proposal, however, died in both committees. The House committee took the position that other remedies, such as injunctions, disclosure requirements, and investigations, would more effectively combat abuses.<sup>138</sup> The Senate report discussed the point in more detail: to give the Secretary of Labor the power to take away a union's tax exemption, would be an "unsound and unfair . . . method of coercing obedience to legal duties."<sup>139</sup> The Senate committee criticized the severity of such a penalty imposed on an all-or-nothing basis, bearing no relation to the gravity of the offense. It also objected to the difficulty of the factual determination that would have to be made. Lastly, it opposed the unfairness of penalizing the general union membership for the offenses of its officers.<sup>140</sup> In the legislation finally enacted, the Secretary was empowered only to investigate charges of corruption, to make reports, and to inform interested persons of his findings.<sup>141</sup>

Though denial of tax exemption was considered inappropriate as a means of coping with the problem of union corruption, the Treasury Department has taken preliminary steps to employ the tax machinery to control union political activity. Though union members may deduct from their gross income dues,<sup>142</sup> initiation fees, and other con-

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<sup>137</sup> See *Hearings on S. 505 Before the Subcommittee on Labor of the Senate Committee on Labor and Public Welfare*, 86th Cong., 1st Sess. 279-303 (1959).

<sup>138</sup> H.R. REP. NO. 741, 86th Cong., 1st Sess. 27 (1959).

<sup>139</sup> S. REP. NO. 187, 86th Cong., 1st Sess. 10 (1959).

<sup>140</sup> *Ibid.*

<sup>141</sup> Labor-Management Reporting & Disclosure Act, § 601, 73 Stat. 539 (1959), 29 U.S.C.A. § 521 (Supp. 1961). The decision not to use loss of tax exemption as a sanction to check corruption will likely be accepted by the Kennedy administration. The Senate Report repeats almost verbatim testimony and formal statements of Professor Archibald Cox, now Solicitor General. Cox was at the time chief adviser to then Senator Kennedy, prime exponent of labor reform legislation. Former Secretary of Labor Goldberg, then special counsel to the AFL-CIO, attacked the proposal in his appearance before the Senate Committee.

<sup>142</sup> In practice, this is of little consequence as most taxpayers in lower brackets elect the standard deduction. See IRS STATISTICS OF INCOME 1 (1960). But the principle of deductibility should be maintained. The cost of union membership is a legitimate business expense of the working man.

tributions used for ordinary labor activities,<sup>143</sup> a 1959 regulation denies in part a deduction for contributions to groups which devote a substantial part of their efforts to influencing legislation.<sup>144</sup> In view of the considerable amount of political activity now sponsored by labor organizations,<sup>145</sup> the regulation seems entirely proper; indeed it may not go far enough. It is limited to those groups which devote a "substantial part" of their activities to influencing legislation. However large lobbying expenses may be, they are only a small part of total union budgets. To date there is no evidence as to whether the Treasury will attempt to apply the regulation to such unions. If it should decide to do so, administration of the restriction will be made easier by the reporting requirement of the Landrum-Griffin Act.<sup>146</sup>

Another precedent for altering the tax treatment of unions may be found in section 504 of the Code. This section denies tax exemption to any public welfare organization which accumulates an unreasonable amount of income in any one year or which devotes substantial funds to purposes other than those for which the exemption is granted. The purpose of the provision—"to force so-called charitable organizations to spend currently the money which they receive for purposes upon which their favored tax status is based"<sup>147</sup>—might well be extended to unions.

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<sup>143</sup> I.T. 2888, XIV-1 CUM. BULL. 54 (1935) (assessments for families of sick or deceased members nondeductible; assessments for unemployment benefits deductible); Rev. Rul. 190, 1954-1 CUM. BULL. 46 (assessments for pension fund required by union constitution deductible).

<sup>144</sup> Treas. Reg. § 1.162-15 (1959), as amended, T.D. 6435, 1960-1 CUM. BULL. 79.

<sup>145</sup> In contrast to European trade unions which have traditionally been centers of political controversy, American unions have only recently entered the arena of political activity. See BARBASH, PRACTICE OF UNIONISM 246 (1954); Chamberlain, *The Corporation and the Trade Union*, in THE CORPORATION AND MODERN SOCIETY 122 (1960). Unions now act on three fronts: campaigning for pro-labor candidates, lobbying for specific legislation, and insisting on a voice in the formation of broad national policy. Official reports filed with Congress showed that the labor movement spent almost \$2,500,000 in the 1960 presidential campaign, most of it to back President Kennedy and other Democratic candidates. In the combined national, state, and local campaigns, the unions expended a sum estimated at more than \$5,000,000. See Raskin, *The Unions and Their Wealth*, *The Atlantic*, April 1962, p. 87. Mr. Raskin notes that "with the decline of the big city party organizations, unions are now by all odds the most dependable mechanism for swelling registration." *Id.* at 95. Unions also provide crowds for political rallies. They have spent \$500,000 for voter registration drives. *N.Y. Times*, Feb. 23, 1961, p. 19, col. 6. See also Sviridoff, *Political Participation by Unions: The 1960 Situation*, 11 LAB. L.J. 639 (1960). It should be noted that § 304 of the Labor-Management Relations Act, 61 Stat. 149 (1947), 18 U.S.C. § 610 (1958), forbids union contributions or expenditures "in connection with any election" for federal office and this has been construed to mean that union funds cannot be used to influence the public at large. See *United States v. UAW*, 352 U.S. 567 (1957); GREGORY, LABOR AND THE LAW 541-43 (1949).

<sup>146</sup> Labor-Management Reporting & Disclosure Act, tit. II, § 201(a)-(c), 73 Stat. 524 (1959), 29 U.S.C.A. § 431 (Supp. 1961). See President's labor message to Congress, Jan. 23, 1958 (relating to Taft-Hartley amendments, part I(b)(b)(3)), *N.Y. Times*, Jan. 24, 1958, p. 8, col. 4.

<sup>147</sup> 96 CONG. REC. 14057 (remarks by Sen. Milliken).

If Congress should decide to revise the present Code provisions applicable to labor organizations, three possibilities should be explored. Dues and assessments, currently the largest source of exempt funds, could be taxed. This would drastically reduce union income. Inasmuch as these funds are somewhat analogous to untaxed contributions to corporate capital, such an approach would perhaps be inequitable. Investment income is the other major source of tax-exempt income. If the major aim of Congress should be to limit the accretion of union wealth and power generally, an across-the-board levy would be both feasible and appropriate. If, on the other hand, Congress should be concerned only with the effects of union investment in corporate securities, it could impose a tax on dividends received by labor organizations and continue the present exemption for rents and interest. Such selective application of the taxing power would give Congress the flexibility needed to deal with the specific problems it deems to be of greatest significance.