The Catholic Lawyer

Volume 28
Number 2 *Volume 28, Spring 1983, Number 2*

Article 14

September 2017

# Tax Exemption and Racial Discrimination

John A. Liekweg, Esq.

# TAX EXEMPTION AND RACIAL DISCRIMINATION

JOHN A. LIEKWEG, ESQUIRE

## INTRODUCTION

The subject of tax exemption and racial discrimination is a familiar one for this group, having been on the agenda at the 1976 and 1980 Diocesean Attorneys Meetings.[1] Recent significant developments, in particular the administration's proposed legislation to amend section 501 of the Internal Revenue Code to preclude tax-exempt status for private schools that discriminate on the basis of race, require that once again this controversial subject be analyzed and discussed. It is important to note at this point that the United States Catholic Conference has not taken a position on the legislation. This presentation is intended primarily to identify issues, not to provide answers or make recommendations.

## BACKGROUND

Before addressing the issues it would be useful to bring you up to date on recent developments. In 1970, the Internal Revenue Service (IRS), spurred by *Green v. Connally*,[2] announced that it would no longer recognize racially discriminatory private schools as exempt under section 501(c)(3) of the Internal Revenue Code.[3] Subsequently, in a series of revenue rulings and procedures, the IRS made it clear that religious schools, and churches operating schools that do not accept students on the basis

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[1] *See* Liekweg, *Relationship of Civil Rights Issues to Education and Taxation*, 26 CATH. LAW. 186, 186-97 (1981); Rumph, *Revenue Procedure on Racial and Ethnic Discrimination in Schools*, 22 CATH. LAW. 209, 209-18 (1976).

[2] 330 F. Supp. 1150 (D.D.C.), *aff'd sub nom.* Coit v. Green, 404 U.S. 997 (1971). The district court provided an overview of the litigation prior to the 1971 decision. 330 F. Supp. at 1155-56. The court held that racially discriminatory private schools are not entitled to a tax exemption and persons making gifts to such schools are not entitled to deductions. *Id.* at 1179-80.

[3] 330 F. Supp. at 1156 & n.3.

of race do not qualify for exemption under section 501(c)(3).[4] In 1978, the IRS, again spurred by litigation,[5] published a proposed revenue procedure ostensibly intended to provide more effective guidelines for identifying private schools that discriminate.[6] The proposed procedure met with a storm of protests from a broad range of representatives of private education, and was revised by the IRS in 1979, but was never finalized nor implemented because of provisions enacted by Congress during the past several years as part of appropriations legislation.

As this controversy developed, *Goldsboro Christian Schools*[7] and *Bob Jones University*[8] were working their way up to the United States Supreme Court. Both of those cases involved disputes with the IRS over discriminatory policies based on religious beliefs. In *Goldsboro Christian Schools*, an admissions policy is at issue, while in *Bob Jones University*, a policy against interracial dating is involved. In both cases the IRS' refusal to recognize the school as exempt was upheld by the United States Court of Appeals for the Fourth Circuit. In October, 1981, the Supreme Court granted certiorari in both cases.[9]

On January 8, 1982, the United States Treasury Department announced that, without further guidance from Congress, the IRS would no longer revoke or deny exempt status for religious, charitable, educational, or scientific organizations on the ground that they do not conform to certain fundamental public policies, specifically mentioning the policy against racial discrimination.[10] The announcement stated that the change in position reflected the advice of the Department of Justice that the authority previously asserted by the IRS as its basis for revoking the tax exemptions of certain schools was supported by neither the language of the Code nor its legislative history. On the same day, the Department of Justice advised the Supreme Court that the Treasury Department had initiated steps to reinstate the exempt status of Goldsboro Christian Schools and Bob Jones University and asked the Court to vacate the judgments of the Fourth Circuit.

Predictably, the government's announcement of its change in policy

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[4] *E.g.*, Rev. Rul. 447, 1971-2 C.B. 230; Rev. Rul. 231, 1975-1 C.B. 158; Rev. Proc. 72-54, 1972-2 C.B. 834; Rev. Proc. 75-50, 1975-2 C.B. 587.

[5] Wright v. Miller, 480 F. Supp. 790 (D.D.C. 1979), *rev'd sub nom.* Wright v. Regan, 656 F.2d 820 (D.C. Cir. 1981).

[6] 43 Fed. Reg. 37,296-98 (1978); Liekweg, *supra* note 1, at 194.

[7] Goldsboro Christian Schools, Inc. v. United States, 644 F.2d 879 (4th Cir. 1980), *cert. granted*, 454 U.S. 892 (1981).

[8] Bob Jones Univ. v. United States, 639 F.2d 147 (4th Cir. 1980), *cert. granted*, 454 U.S. 892 (1981).

[9] Both cases have been carried over to the Supreme Court's docket. *See* 51 U.S.L.W. 3021 (U.S. Aug. 3, 1982) (Nos. 81-1, 81-3).

[10] N.Y. Times, Jan. 9, 1982, at 1, col. 2.

generated an enormous amount of public controversy. In response, on January 18, President Reagan sent to Congress proposed legislation intended to give the IRS express authority to deny exempt status to private educational organizations with racially discriminatory policies. Of particular interest to religious schools is that the legislation is not intended to apply to seminaries and Sunday schools, and would allow other religious or church-related schools to give preferences or priorities to members of their own religion, provided the policy is not based upon race or a belief that requires discrimination based upon race. Limited hearings have been held in both the House and the Senate, but it is unlikely that the legislation will move very rapidly.

In another somewhat surprising development, last February the Justice Department asked the Supreme Court to hear the two cases but indicated that the Court should appoint special counsel to argue the government's position that discriminatory schools do not qualify for exemption under section 501(c)(3). On April 19, the Supreme Court invited William T. Coleman, former Secretary for the Department of Transportation, to brief and argue the cases, as *amicus curiae,* in support of the Fourth Circuit judgments.

## POLICY AGAINST RACISM—NATIONAL POLICY AND THE CATHOLIC CHURCH

In analyzing legislation of this kind, it is important to keep in mind the Church's teaching on racial discrimination as well as the national policy against racial discrimination. The Catholic Church in this country has consistently maintained that the heart of the race question is moral and religious and that discrimination based upon race, language, religion or national origin is contrary to right, reason and Christian teaching.[11] Regarding education, the Church has long recognized that education is a basic need and that quality education for the poor, especially minorities who have been traditionally victims of discrimination, is a moral imperative.[12] The Church's commitment to equal educational opportunity in both public and nonpublic schools, including its own is well established.

The federal government also has a well-established policy against racial discrimination, although its perimeters are not precisely defined. The policy is reflected in a number of constitutional, statutory, and regulatory provisions, the application of which can vary substantially depending upon the nature of the discrimination being proscribed, discouraged or remedied. To illustrate, the Supreme Court has made clear in a series of

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[11] National Conference of Catholic Bishops, *Brothers and Sisters To Us—U.S. Bishops' Pastoral Letter on Racism In Our Day* (1979).

[12] *See* National Conference of Catholic Bishops, *To Teach as Jesus Did—U.S. Bishops' Pastoral Message on Catholic Education* (1973).

cases that the equal protection clause of the fourteenth amendment prohibits only invidious intentional discrimination by governmental bodies or officials.[13] At the same time, the Court has recognized that Congress through legislation can proscribe or penalize acts that have the effect of discriminating, albeit unintentionally.[14] Respectively, these shall be referred to as the "intent standard" and the "effects standard." In addition, affirmative action or nondiscrimination requirements attach to participation in almost every conceivable federal program.

In enacting legislation, it is important that it be made clear what kind of discriminatory activity is being addressed and what is to be expected of the affected schools. While the Church's position on racism and the federal government's policy against racial discrimination are consistent, the Church must be ever vigilant to assure that in furthering its policy the government does not unreasonably interfere with or burden the Church's legitimate governmental activities.

## STANDARD FOR DETERMINING DISCRIMINATION

One of the critical issues in the proposed legislation is the standard to be used in determining discrimination. Will only intentional discrimination be prohibited or will acts that have a disproportionate impact or effect on minorities also be prohibited? The recent experience with the 1978 proposed procedure accentuates the need for clear and reasonable standards in any legislation addressing the issue of racial discrimination in private schools.

Adoption of an effects standard could have a substantial impact on the operations of private schools. A few examples should suffice to illustrate the potential impact. The absence of a bilingual program, or the adoption of a particular type of language program could adversely affect the enrollment or participation of non-English speaking children in a school. Admissions tests and ability grouping tests may have a disproportionate effect on certain racial and ethnic groups. Giving preference to members of a particular religion or parish could result in low minority enrollment in a school. These situations can arise for legitimate nondiscriminatory reasons.

An intent standard on the other hand, is not likely to affect the oper-

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[13] *See, e.g.*, Castaneda v. Partida, 430 U.S. 482, 493 (1977) ("substantial underrepresentation of a group constitutes a constitutional violation . . . if it results from [the state's] purposeful discrimination"); Washington v. Davis, 426 U.S. 229, 239 (1976) ("The central purpose of the Equal Protection Clause of the Fourteenth Amendment is the prevention of official conduct discriminating on the basis of race.").

[14] *See, e.g.*, Washington v. Davis, 426 U.S. 229, 238-39 (1976) (title VII of the Civil Rights Act of 1964 has a more stringent test for violation of equal protection than that required under the Constitution).

ations of nondiscriminatory schools and is consistent with the Constitution's prohibition against invidious intentional discrimination and the Church's position condemning racism as sinful. An effects standard could also be said to be consistent with the Church's positions on equal educational opportunity and affirmative action.

### AFFIRMATIVE DUTIES

An issue that must be addressed is what affirmative duties, if any, should be required of exempt schools if legislation is enacted. Currently, under Revenue Procedure 75-50, exempt private schools must meet certain requirements regarding adoption of a formal policy of nondiscrimination, publication and certification of that policy, and recordkeeping.[15]

The 1978 proposed procedure raised concerns that private schools might be required to engage in active and vigorous recruitment programs, provide financial assistance to minority students, adopt special minority-oriented curriculum, and appoint minority members to the governing body of the school. While all or any of these kinds of actions are certainly laudatory and indicate that a school does not discriminate, their absence does not necessarily mean that a school does discriminate. It is readily apparent that a mandatory requirement for some or all of the actions could place a severe burden on religious schools. The potential for overly burdensome regulatory requirements will have to be scrutinized carefully in evaluating the proposed legislation.

### EXTENT OF IRS INVOLVEMENT WITH PRIVATE SCHOOLS

Any legislation conditioning exempt status on a school's adherence to a policy of racial nondiscrimination will inevitably lead to some interaction between schools and the IRS. An important issue in the proposed legislation is the extent of IRS authority to examine the activities of private schools; that is, how and under what circumstances can the IRS determine what a school's policies and practices are? The type and scope of IRS inquiries can vary immensely, ranging from a simple telephone call to an on-site examination.

In evaluating the proposed legislation, consideration will have to be given to including safeguards reasonably designed to protect schools, particularly religious and church-related schools, from unreasonable inquiries or harassment by the IRS. Limitations similar to those in effect for churches under section 7605(c) of the Code could be considered.[16]

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[15] Rev. Proc. 50, 1975-2 C.B. 587, 587-89.

[16] *See* I.R.C. § 7605(c) (1982). Section 7605(c) provides:

> No examination of the books of account of a church or convention or association of churches shall be made to determine whether such organization may be engaged in

### SHOULD EXEMPT STATUS DEPEND ON COMPLIANCE WITH NATIONAL POLICY?

In the continuing controversy over tax exemptions for discriminatory private schools a basic question underlying the whole issue has tended to be overlooked: is it good policy to condition exempt status on compliance with a national social policy? The concept has its difficulties.

Requiring all organizations exempt under section 501(c)(3) to comply with a particular social policy, assuming that the policy can be clearly identified, would seem to undermine the diversity and pluralism that is the strength of the private voluntary sector. From a practical standpoint, adding another condition for qualification to section 501(c)(3) would further complicate an already complicated section of the Code. The lobbying and political activity restrictions in section 501(c)(3) have proved to be controversial and difficult to administer and interpret. No less can be expected of a provision relating to racial discrimination. The addition of a racial nondiscrimination requirement could lead to pressure to condition exempt status on compliance with public policies against other forms of discrimination. Moreover, to condition exempt status on compliance with one social policy opens the door to requirements of compliance with others. Once having adopted the concept, it may be difficult to contain.

On the other side, there is the argument that the federal government should not provide any benefits at all to discriminatory schools, including tax benefits, however indirect. In addition, there is the somewhat speculative contention that the threat of loss of exempt status could have the positive effect of inducing some schools to abandon discriminatory policies and thereby increase educational opportunities for minorities who choose to enroll. Whether this basic policy question will receive serious consideration during the legislative process remains to be seen.

### ALTERNATIVE MEANS OF ATTACKING RACIAL DISCRIMINATION

The government's precise interest in proposing this legislation is to ensure that the federal government does not provide any direct or indirect assistance or benefits through the tax code to private schools that

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> the carrying on of an unrelated trade or business or may be otherwise engaged in activities which may be subject to tax under part III of subchapter F of title 1 of this title unless the Secretary . . . believes that such organization may be so engaged and so notifies the organization in advance of the examination. No examination of the religious activities of such an organization shall be made except to the extent necessary to determine whether such organization is a church or a convention or association of churches, and no examination of the books of account of such an organization shall be made other than to the extent necessary to determine the amount of tax imposed by this title.

*Id.*

discriminate on the basis of race. The logical means of achieving this narrow interest is by amending the Internal Revenue Code. In this sense there are no alternative approaches available outside the Code.

If the ultimate goal, however, is to eliminate discrimination in private education, as arguably it should be, more direct and efficient means of achieving this goal could be employed than denial of exempt status. For example, through legislation a new private right of action could be created to protect individuals against discrimination. Civil and criminal penalties could be levied against schools that discriminate on the basis of race. This could be a greater deterrent to the practice of racial discrimination than a denial of tax benefits.

In addition, there are other available means of attacking the problem of racial discrimination in private schools. Presently, private schools that discriminate on the basis of race are ineligible to receive federal financial assistance under Title VI of the Civil Rights Act of 1964.[17] Private schools are subject to Title VII's proscriptions against discrimination in employment practices.[18] Private schools, including religious schools, with racially discriminatory admissions policies have been held subject to compensatory and injunctive relief under section 1 of the Civil Rights Act of 1866.[19]

While the alternatives suggested above would more directly, and perhaps more effectively, address the problem of racial discrimination, their serious consideration under present circumstances may be difficult. The controversy over tax exemptions for schools that discriminate has raged for more than 10 years and the narrow focus has been on withdrawing tax benefits from discriminatory schools.

## PROS AND CONS OF THE PRESIDENT'S LEGISLATION

The legislation proposed by President Reagan would amend section 501 of the Code by adding a new subsection, (j), which provides that an organization which normally maintains a regular faculty and curriculum, other than an exclusively religious curriculum, and has a regularly enrolled body of students shall not be exempt from tax if the organization has a racially discriminatory policy. In addition to denying exempt status to organizations that operate schools with a racially discriminatory policy, the legislation would also amend other sections of the Code to deny as charitable deductions contributions to such organizations for individual and estate and gift tax purposes.

The proposed legislation has both good and bad features. On the positive side it specifically recognizes the special concerns of religious schools

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[17] 42 U.S.C. § 2000d (1976 & Supp. IV 1980).
[18] *See id.* § 2000e.
[19] *Id.*

by allowing them to give preferences to members of their own religions. It also is not intended to apply to exclusively religious schools such as seminaries and Sunday schools, and, thus, reduces the potential for governmental involvement in purely religious matters. An additional positive feature is that on its face it appears to address discriminatory policies and practices rather than individual acts of discrimination that may be isolated or aberrational.

On the negative side the proposed legislation is ambiguous in some respects and does not contain any limitations on the extent of the IRS authority to investigate religious schools. The use of the term "exclusively religious curriculum" to define certain schools not covered by the legislation could be problematic. Under this definition the IRS will be required to determine whether a particular school's curriculum is exclusively religious, a determination that will necessarily involve the IRS in the constitutional dilemma of evaluating the religious nature of a school's curriculum. At many schools, in addition to seminaries and Sunday schools, religion permeates the entire curriculum. The use of an exclusively religious test inevitably will lead to controversies between such schools and the IRS, and, therefore, the legislation will be difficult to administer.

The proposed legislation does not establish clearly the kind of discrimination being addressed. The use of an effects standard potentially would have a far greater impact on the operations of private schools than would an intent standard. The standard to be applied should be addressed squarely in such legislation.

One final note, the proposed legislation, as does Revenue Procedure 75-50, would deny exempt status for discrimination based on color and national origin. To develop a legitimate position on the legislation, this factor and indeed all others previously mentioned will have to be given the utmost consideration.