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Constitutional Law - Charitable Tax Exemptions - Granting of Tax Benefits to Discriminatory Fraternal Orders is a Violation of the Equal Protection Aspect of the Fifth Amendment

Marc Howard Jaffe

damages so that they might serve as private attorneys general.[104] However, since the concept of a suit by a state as *parens patriae* to redress antitrust violations is no longer viable, the courts should now concern themselves with the question of workable alternatives which would be in the best interests of those consumers faced with compensable — albeit small — injuries due to violations of the antitrust laws.[105]

James M. Papada, III

CONSTITUTIONAL LAW — CHARITABLE TAX EXEMPTIONS — GRANTING OF TAX BENEFITS TO DISCRIMINATORY FRATERNAL ORDERS IS A VIOLATION OF THE EQUAL PROTECTION ASPECT OF THE FIFTH AMENDMENT.

McGlotten v. Connally (D.D.C. 1972)

Plaintiff, a black American allegedly denied membership in a fraternal order[1] solely because of his race, brought a class action in federal district court seeking to enjoin[2] the Secretary of the Treasury from granting tax benefits to fraternal and nonprofit organizations which discriminate in their membership on the basis of race.[3] Plaintiff contended that the

104. *See, e.g.*, Zenith Radio Corp. v. Hazeltine Research, Inc., 395 U.S. 100, 130–31 (1969).

105. It would seem that only two approaches remain. First, a class action might be brought pursuant to FED. R. CIV. P. 23. However, in the instant case the class action count was dismissed as "unmanageable" by the district court. *See* note 8 *supra*. Second, an individual consumer might sue in his own right, but this approach also is fraught with difficulties — cost of initiation of the suit, attorney fees, and discovery costs. When weighed against the comparatively small amount of damage which one consumer or even a group of consumers usually sustains in such an action, the cost of the suit becomes prohibitive for him. *See* Comment, *supra* note 30, at 570–71.

1. The fraternal order in question was the Benevolent and Protective Order of Elks. McGlotten v. Connally, 338 F. Supp. 448, 450 (D.D.C. 1972).

2. Plaintiff sought the following relief: (1) to enjoin the Internal Revenue Service from any further approval of applications by segregated nonprofit clubs and fraternal orders for tax exempt status under INT. REV. CODE of 1954, §§ 501(c)(7) & (8); (2) to require the revocation of tax exemptions previously issued such groups; and (3) to require the promulgation of regulations prohibiting the granting of tax exempt status to any segregated nonprofit club or fraternal order. Additionally, plaintiff requested similar relief with respect to INT. REV. CODE of 1954, §§ 2055, 2106(a) & 2522 which provide for deductibility of contributions for estate and gift tax purposes. *Id.*

3. Section 144 of the Constitution and statutes of the Grand Lodge of the Benevolent and Protective Order of Elks provides in pertinent part that

> No person shall be accepted as a member of this Order unless he be a white male citizen of the United States of America . . .

The By–Laws and Rules of Order of Portland, Oregon, Lodge #142 conform to the National Constitution in Article II: Membership § 1:

> Applications for membership shall be received only from white male citizens of the United States of America . . . .

Id. at 450 n.1.

Internal Revenue Code of 1954 (the "Code") did not, in fact, authorize such tax benefits; that if it did, the sections of the Code involved were unconstitutional; and that these benefits were a form of federal financial assistance in violation of Title VI of the Civil Rights Act of 1964[4] (the "Act"). Defendant moved to dismiss the complaint both on jurisdictional grounds[5] and for failure to state a claim upon which relief could be granted.[6]

The United States District Court for the District of Columbia dismissed the complaint as it applied to nonprofit clubs but found that the plaintiff stated a claim upon which relief could be granted with respect to fraternal orders. The court *held* that the granting of exemptions from the income tax and the granting of deductions to the income tax for contributions to fraternal orders which discriminate in their membership on the basis of race was impermissible "state action,"[7] unconstitutional under the equal protection aspect of the due process clause of the fifth amendment; contrary to the congressional policy against racial discrimination; and, violative of Title VI of the Act.[8] *McGlotten v. Connally,* 338 F. Supp. 448 (D.D.C. 1972).

The two basic issues involved were whether the granting of these tax benefits constituted "state action" so as to be within the scope of the due process clause of the fifth amendment and whether they constituted federal financial assistance within the meaning of Title VI of the Act. The court split the first question into three distinct issues: (1) whether the granting of a deduction for contributions to discriminatory fraternal orders was sufficient federal involvement to constitute unconstitutional "state action;" (2) whether the granting of tax exemptions to nonprofit clubs (other than fraternal orders) which discriminate was sufficient federal involvement to constitute unconstitutional "state action;" and (3) whether the granting of tax exemptions to fraternal orders which discriminate is sufficient federal involvement to constitute unconstitutional "state action."

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4. 42 U.S.C. § 2000d (1970). *See* note 67 *infra.*

5. The court felt that both Zemel v. Rusk, 381 U.S. 1 (1965), and Flast v. Cohen, 392 U.S. 83 (1968), required the convening of a three-judge court where there was a substantial constitutional claim, even though the attack was on the constitutionality of a statute as applied and was coupled with a claim that the action in question was not authorized by the statute. Finding the plaintiff's constitutional claims substantial, the court held the three-judge court to be properly convened.

Relying on *Flast* and Association of Data Processing Service Organizations, Inc. v. Camp, 397 U.S. 150 (1970), the court reasoned that "a black American has standing to challenge a system of federal support and encouragement of segregated fraternal organizations." 338 F. Supp. at 452. Finally, the court held that neither the Tax Injunction Act, 26 U.S.C. § 7421(a) (1970), nor the Declaratory Judgment Act, 28 U.S.C. §§ 2201–55 (1970), prohibited the instant suit because the central purpose of those acts was clearly inappropriate to the case. 338 F. Supp. at 453–54.

6. Since the instant case was decided on the Government's motion to dismiss, the court assumed plaintiff's allegations were true and did not decide whether, on the merits, the alleged discrimination violated equal protection.

7. "State action" is used throughout this note in a broad sense to include any actions by either the state or federal governments or other parties which lie within the purview of the equal protection clause of the fourteenth amendment and the equal protection aspect of the due process clause of the fifth amendment.

8. 42 U.S.C. § 2000d (1970).

A finding of "state action" is the prerequisite to the conclusion that there has been a denial of equal protection under the due process clause of the fifth amendment[9] as well as the equal protection clause of the fourteenth amendment.[10] The requirement of "state action" is certainly met by direct actions of the legislative, executive, and judicial branches of the state or federal governments.[11] However, the courts have been somewhat reluctant to extend the restrictions of the equal protection clause of the fourteenth amendment to acts by private individuals and organizations, even though the government may be indirectly involved, in light of the *Civil Rights Cases*,[12] which held that the fourteenth amendment was inapplicable to purely private discrimination. Thus, between the area of purely private discrimination and direct governmental action, there exists a murky area

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9. Originally the equal protection requirement was thought to pertain only to the actions of the state governments and not the federal government. Detroit Bank v. United States, 317 U.S. 329 (1943); Truax v. Corrigan, 257 U.S. 312 (1921). However, in Bolling v. Sharpe, 347 U.S. 497 (1954), the Supreme Court held that "discrimination may be so unjustifiable as to be violative of due process," thus formulating an equal protection aspect of the fifth amendment's due process clause. *Id.* at 499. It is now a generally accepted rule of constitutional law that the equal protection requirement applies both to the state and federal governments. For an excellent study of the original understanding of equal protection, *see* Frank & Munro, *The Original Understanding of "Equal Protection of the Laws,"* 50 COLUM. L. REV. 131 (1950). For an equally excellent study of the entire area of equal protection, *see Developments in the Law — Equal Protection,* 82 HARV. L. REV. 1065 (1969).

10. The Supreme Court, in the Civil Rights Cases, 109 U.S. 3 (1883), established the principle that state action was necessary before the equal protection clause of the fourteenth amendment could be invoked. The Court held that only action by a state and not "[i]ndividual invasion of individual rights is . . . the subject-matter of the amendment." *Id.* at 11. This principle has been consistently reiterated by the Court:

> Since the decision of that Court in the *Civil Rights Cases* . . . the principle has become firmly embedded in our constitutional law that the action inhibited by the first section of the Fourteenth Amendment is only such action as may fairly be said to be that of the States. That Amendment erects no shield against merely private conduct, however discriminatory or wrongful.

Shelley v. Kraemer, 334 U.S. 1, 13 (1948). *See also* Horowitz, *The Misleading Search for "State Action" Under the Fourteenth Amendment,* 30 S. CAL. L. REV. 208 (1957).

In his dissent in the *Civil Rights Cases,* Mr. Justice Harlan suggested that a private corporation exercising a public or quasi-public function when it acted, should be deemed to be acting for the state and subject to the fourteenth amendment. *See* 109 U.S. at 58–59. *See also* Dorsey v. Stuyvesant Town Corp., 299 N.Y. 512, 536, 87 N.E.2d 541, 551 (1949) (Fuld, J., dissenting), *cert. denied,* 339 U.S. 981 (1950).

11. *See* Abernathy, *Expansion of the State Action Concept Under the Fourteenth Amendment,* 43 CORNELL L.Q. 375 (1958), where the author noted that:

> The Court rather early began the extension of the term state action to cover not only legislative action . . . but action of the judicial and executive branches as well. And there was a vertical extension to include all governmental units subordinate to the state. The Court has found violations of the amendment by the state courts, legislatures, executives, tax boards, boards of education, counties, and cities, among others.

Id. at 378 (footnotes omitted). *See also* Black, *Foreword: "State Action," Equal Protection and California's Proposition 14,* 81 HARV. L. REV. 69, 86 (1967); Henkin, *Shelley v. Kraemer: Notes for a Revised Opinion,* 110 U. PA. L. REV. 473, 482–87 (1962); Van Alstyne & Karst, *State Action,* 14 STAN. L. REV. 3 (1961); Reference, *State Action — A Study of Requirements Under the Fourteenth Amendment,* 1 RACE REL. L. REP. 613 (1956).

12. 109 U.S. 3 (1883). *See* note 10 *supra.*

where a significant degree of indirect governmental involvement can become "state action" for purposes of the fifth or fourteenth amendments.

Since the "state action" requirement was delineated in the *Civil Rights Cases,* courts have devised various theories by which to find that the indirect involvement of the government with a private organization or individual is "state action."[13] However, the Supreme Court has never arrived at a concrete definition of what exactly constitutes "state action."[14] In *Burton v. Wilmington Parking Authority,*[15] the Court said:

> [T]o fashion and apply a precise formula for recognition of state responsibility under the Equal Protection Clause is an "impossible task" which "This Court has never attempted." . . . Only by sifting facts and weighing circumstances can the non-obvious involvement of the State in private conduct be attributed its true significance.[16]

Through the application of this case-by-case approach, the courts have found "state action" where the government was so involved with a private organization that the activities of the organization were not purely private. However, the view that the provision of state financial aid was sufficient governmental involvement had not always been accepted,[17] and even today,

13. Among the situations where state action has been found are: (1) a private individual discriminating under state mandate (Buchanan v. Warley, 245 U.S. 60 (1917); Truax v. Raich, 239 U.S. 33 (1915); Flemming v. South Carolina Elec. & Gas Co., 224 F.2d 752 (4th Cir. 1955); *see* Reference, *supra* note 11, at 630–31); (2) an organization performing quasi-governmental functions (Marsh v. Alabama, 326 U.S. 501 (1964) (privately owned town); Steele v. Louisville & N.R.R., 323 U.S. 192 (1944) (labor union); Nixon v. Condon, 286 U.S. 73 (1932) (political party); *see* Reference, *supra* note 11, at 635–37); (3) a lessee from the state (Burton v. Wilmington Parking Authority, 365 U.S. 715 (1961); *see* Reference, *supra* note 11, at 631–33); and (4) a private organization acting with apparent government approval (Burton v. Wilmington Parking Authority, 365 U.S. 715 (1961)).

14. This may not be an undesirable position for the Supreme Court, because as one commentator suggested, if there were one exclusive theory or even five set theories as to what private action constituted "state action," the concept would become a shelter to racism since it could never encompass all the endless variations which could be devised by those wishing to discriminate. The doctrine must remain vague and ambiguous or else become arbitrary. Black, *supra* note 11, at 90–91.

15. 365 U.S. 715 (1961).

16. *Id.* at 722, *quoting* Kotch v. Board of River Comm'rs, 330 U.S. 552, 556 (1947). This position was reiterated by the Court in Reitman v. Mulkey, 387 U.S. 369 (1967):

> This Court has never attempted the "impossible task" of formulating an infallible test for determining whether the State "in any of its manifestations" has become significantly involved in private discriminations.

Id. at 378.

17. In Kerr v. Pratt Free Library, 149 F.2d 212 (4th Cir.), *cert. denied,* 326 U.S. 721 (1945), the court held that state financial aid plus a certain degree of government control rendered the library's actions "state action." *See* Abernathy, *supra* note 11, at 388. However, in Norris v. Mayor & City Council, 78 F. Supp. 451 (D. Md. 1948) (subsidy from state and city represented 20 per cent of total income), the court distinguished *Kerr* by reason of the control exercised by the state and held that financial aid alone would not support a finding of state action. In Dorsey v. Stuyvesant Town Corp., 229 N.Y. 519, 87 N.E.2d 541 (1949), it was held that aid by the government in the form of tax exemptions and use of the power of eminent domain was insufficient to be considered state action.

The United States District Court for the District of Columbia held in Mitchell v. Boys Club, 157 F. Supp. 101 (D.D.C. 1957), that aid given by the Government to a private corporation was insufficient in itself to change the character of the corporation from private to public. In that case, a Negro youth sought to have the boys club declared an agency of the Government and to enjoin its denial

it is unclear whether any financial aid whatsoever[18] subjects a private organization to the restrictions of the fourteenth amendment a fortiori. At present it would seem that under the *Poindexter v. Louisiana Financial Assistance Commission* test,[19] any purposeful aid to discrimination, or under the *Griffin v. State Board of Education* test,[20] any significant aid which has the effect of fostering discrimination, though not purposefully discriminatory, could be deemed unconstitutional "state action."[21]

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of membership solely on the basis of his race. The club was allowed the use of District of Columbia facilities, and funds were solicited by the police for the club but no public moneys were used to support it. However, in Statom v. Board of Comm'rs, 233 Md. 57, 195 A.2d 41 (1963), the court held, upon circumstances almost identical to those in *Mitchell,* that discriminatory activities of a boys club were "within the ambit of conduct proscribed by the Equal Protection Clause." *Id.* at 66, 195 A.2d at 47. The court reasoned that the donation of public property to the club was more clearly supportive of a finding of state action than the leasing of public property by the state in the *Burton* case. Moreover, the court indicated that *Mitchell* was no longer consistent with the Supreme Court's interpretation of "state action." The *Statom* court did qualify its decision, however, stating that "[a] mere casual or occasional use of, or permission to use, public facilities by a private organization . . ." was not state action because the state had to be involved to a significant extent. *Id.*

18. In Cooper v. Aaron, 358 U.S. 1 (1958), the Supreme Court had indicated in dicta that, at least with respect to racial segregation in schools, it would not permit any state to aid such discrimination:

> State support of segregated schools through *any* arrangement, management, *funds,* or property cannot be squared with the Amendment's command that no State shall deny to any person within its jurisdiction the equal protection of the laws.

Id. at 19 (emphasis added). However, the lower federal courts have not given full effect to this dicta. *See* Griffin v. State Bd. of Educ., 239 F. Supp. 560 (E.D. Va. 1965) (three-judge court), *rev'd,* 296 F. Supp. 1178 (E.D. Va. 1969) (three-judge court); Poindexter v. Louisiana Financial Assistance Comm'n, 275 F. Supp. 833 (E.D. La. 1967) (three-judge court), *aff'd* 389 U.S. 571 (1968); note 21 *infra.*

19. 275 F. Supp. 833 (E.D. La. 1967), *aff'd,* 389 U.S. 571 (1968). *See* note 21 *infra.*

20. 239 F. Supp. 560 (E.D. Va. 1965), *rev'd,* 296 F. Supp. 1178 (E.D. Va. 1969). *See* note 21 *infra.*

21. In Griffin v. County School Bd., 377 U.S. 218 (1964), the Supreme Court held that the government's closing of public schools while contributing to the support of segregated private schools, by means of tuition grants and tax credits for contributions to such schools, was a denial of the right of Negro children to the equal protection of the laws. The Court deemed the financial aid significant but indicated that it was not the sole factor upon which the finding of "state action" was based. A district court in Griffin v. State Bd. of Educ., 239 F. Supp. 560 (E.D. Va. 1965), *rev'd,* 296 F. Supp. 1178 (E.D. Va. 1969), interpreted this Supreme Court decision to mean that the criterion for determining "state action," with respect to financial aid to segregated private schools, was whether "the funds will be used to provide the whole or the greater part of the cost of operation of a segregated school . . . ." *Id.* at 562. However, the aid to the segregated schools was held not to be unconstitutional per se. *Id.* at 563.

Significantly, the district court in *Griffin* did not distinguish between direct grants to schools and the indirect grants to the pupils themselves as provided by the statute in question. Thus, even indirect grants to schools, if sufficient to meet the *Griffin* "predominent" test (a ratio of the amount of the grant to the cost of operation and maintenance), will bring the schools within the equal protection requirement. *See* Spratt, *Federal Tax Exemption for Private Segregated Schools: The Crumbling Foundation,* 12 WM. & MARY L. REV. 1, 32 (1970).

In *Poindexter,* the district court rejected the *Griffin* "predominant" test and found tuition grants to be unconstitutional, holding that:

> Any affirmative and purposeful state aid promoting private discrimination violates the equal protection clause.
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> . . . .
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> . . . The payment of public funds in any amount through a state commission under authority of a state law is undeniably state action. The question

However, the question of what exactly constitutes sufficient state involvement through financial aid such that it will be considered significant remains unanswered. It would seem that where the aid is to assist segregated schools, the courts will have no difficulty in finding the "state action" significant. However, in terms of the weighing and sifting test of *Burton*, the same amount of aid would not necessarily be considered significant when applied to entities other than schools, such as fraternal orders.[22] It

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is whether such action in aid of private discrimination violates the equal protection clause.

. . . .

[D]ecisions on the constitutionality of state involvement in private discrimination do not turn on whether the state aid adds up to 51 per cent or adds up only to 49 per cent of the support of the segregated institution. The criterion is whether the state is so *significantly* involved in the private discrimination as to render the state action and the private action violative of the equal protection clause.

275 F. Supp. at 835, 854 (emphasis supplied by the court). The court felt that the proper focal point was the state's approval or sponsorship of private segregated schools.

The constitutional odium of official approval of race discrimination has no necessary relation to the extent of the State's financial support of a discriminatory institution. Any aid to segregated schools that is the product of the State's affirmative, purposeful policy of fostering segregated schools and has the effect of encouraging discrimination is significant state involvement in private discrimination. (We distinguish, therefore, state aid from tax benefits, free schoolbooks, and other products of the State's traditional policy of benevolence toward charitable and educational institutions.)

Id. *See* Coffey v. State Educ. Finance Comm'n, 296 F. Supp. 1389 (S.D. Miss. 1969); Lee v. Macon Co. Bd. of Educ., 267 F. Supp. 458 (M.D. Ala. 1967), *aff'd sub nom.* Wallace v. United States, 389 U.S. 215 (1967); Lee v. Macon Bd. of Educ., 231 F. Supp. 743 (M.D. Ala. 1964); Hall v. St. Helena Parish School Bd., 197 F. Supp. 649 (E.D. La. 1961), *aff'd*, 368 U.S. 515 (1962).

The *Poindexter* court, finding that the determination of what is significant state involvement may depend on the circumstances, quoted from Commonwealth v. Brown, 270 F. Supp. 782, 788 (E.D. Pa. 1967), *aff'd*, 392 F.2d 120, *cert. denied*, 391 U.S. 921 (1968): "'Where the conscious *purpose* of the State action is to foster discrimination, the mere fact of such action requires constitutional sanctions.'" 275 F. Supp. at 855 (emphasis supplied by the *Brown* court). The court also quoted from Simkins v. Cone Memorial Hosp., 323 F.2d 959 (4th Cir. 1963), *cert. denied*, 376 U.S. 938 (1964):

Where there is no evidence of purposeful participation in private discrimination, the percentage of state aid is relevant . . . [but] "this is not merely a controversy over a sum of money."

275 F. Supp. at 855.

The District Court for the Eastern District of Virginia reversed its opinion in *Griffin v. State Bd. of Educ.* based on the holdings in *Poindexter* and Brown v. South Carolina State Bd. of Educ., 296 F. Supp. 199 (D.S.C. 1968) (three-judge court). The court held:

[A]ny assist *whatever* by the State towards provision of a racially segregated education, exceeds the pale of tolerance demarked by the Constitution. In our judgment, it follows, that neither motive nor purpose is an indispensable element of the breach. The *effect* of the State's contribution is a sufficient determinant, with effect ascertained entirely objectively.

296 F. Supp. at 1181 (emphasis supplied by the court).

See Note, *Tax Exemptions for Racial Discrimination in Education*, 23 TAX L. REV. 399, 417 (1968) ("Evidently, even the slightest government participation in segregated education, if designed purposefully to promote private discrimination, is now forbidden.")

22. *See* Note, *The Tax-Exempt Status of Segregated Schools*, 24 TAX L. REV. 409, 420–21 (1969), where the author suggested that the application of equal protection to deny tax exemptions to private schools could also be applied to discriminatory fraternal organizations. However, private schools serve a public function and therefore the state has a greater interest and obligation to insure that they do not discriminate, while social and fraternal orders serve a more private function

is possible that, in areas other than school desegregation, the courts could look to the *Griffin* test rather than the *Poindexter* test,[23] especially where the aid is in the form of tax benefits — something which the *Poindexter* opinion specifically excluded from its holding.[24] Even though the *Griffin* test can no longer be applied to schools, it still may be applicable in other areas, limiting *Poindexter* and the reversing opinion of *Griffin* to their facts.

Tax benefits are not universally recognized as aid within the meaning of "state action" so as to come within the equal protection requirement.[25] In *Dorsey v. Stuyvesant Town Corp.*,[26] the New York court deemed tax exemptions insufficient state involvement to bring private action within the scope of the fourteenth amendment. However, at that time, financial assistance in general was not necessarily considered to be "state action." Assuming the degree of financial aid by way of tax benefits would be sufficient to be deemed significant state involvement were it direct aid, there is still no certainty that "state action" will be found.[27]

In August 1967, the Internal Revenue Service (the "IRS") said that it would deny tax exemptions to any discriminatory private school that was the direct recipient of state financial assistance, relying on the mandate of *Aaron v. Cooper*,[28] which the IRS believed had held illegal any direct payments by governmental units to private schools organized to evade desegregation.[29] The IRS did not view the exemptions granted to those segregated schools to be "state action" but felt that, if a school received direct aid, such as a tuition grant from the state, it would fall within the requirements of the equal protection clause. The IRS,[30] distinguishing its decision on the basis of charitable trust law,[31] "took the position that contributions to community recreational facilities would be deductible only if the facilities were open on a racially nondiscriminatory basis. No distinction was drawn between state-involved and privately endowed facilities . . . ."[32] These contradictory rulings remained standing until 1970

wherein the rights of association and even discrimination may be protected by the courts.

23. *See* note 21 *supra.*

24. 275 F. Supp. at 854.

25. *See* Note, *Applicability of the Fourteenth Amendment to Private Organizations,* 61 HARV. L. REV. 344, 350 (1948), in which the author suggested certain difficulties in using tax exemptions as a basis for invoking the fourteenth amendment.

26. *See* note 17 *supra.*

27. *See* Guillory v. Administrators of Tulane Univ., 212 F. Supp. 674 (E.D. La. 1962) (state property tax exemption did not constitute state action). *See also* Chicago Joint Bd. v. Chicago Tribune Co., 435 F.2d 470 (7th Cir. 1970); Bright v. Isenbarger, 314 F. Supp. 1382 (N.D. Ind. 1970); Note, *Federal Tax Benefits to Segregated Private Schools,* 68 COLUM. L. REV. 922, 937–38 (1968).

28. 257 F.2d 33 (8th Cir.), *aff'd,* 358 U.S. 1 (1958). *See* note 18 *supra.*

29. N.Y. Times, Aug. 3, 1967, at 24, col. 3.

30. Rev. Rul. 67–325, 1967–2 CUM. BULL. 113.

31. *See* Clark, *Charitable Trusts, the Fourteenth Amendment and the Will of Stephen Girard,* 66 YALE L.J. 979, 993 n.56 (1957).

32. Spratt, *supra* note 21, at 9–10.

when, following the decision of *Green v. Kennedy*,[33] the IRS changed its policy concerning tax exemptions to segregated schools.[34]

In *Green v. Kennedy*, the court analyzed the difference between tax benefits and direct grants and concluded that there was only a difference of degree. The court reasoned that tax benefits under the Code were substantial and significant governmental support — the significant support being the deductions for contributions rather than the exemptions to the schools themselves.[35] The court also stated that the absence of an express discriminatory purpose on the part of the Government did not necessarily mean there was no unconstitutional "state action," especially if the Government action materially supported school segregation.[36] In support of its position, the *Green* court relied upon *Simkins v. Cone Memorial Hospital*.[37] Although *Simkins* applied specifically to outright grants made to a hospital without discriminatory purpose, it was deemed sufficiently analogous to provide "substantial support for a similar ruling in a case of a 'matching grant,' which is in effect the impact of a Federal tax credit or deduction."[38] The court found that the IRS interpretation of the constitutional mandate was too narrow and ignored the significance of current federal support from tax benefits and the impact of past state support. The court did not, however, find it necessary, absent other "state action," to make a final determination of the constitutionality of the tax benefits to private schools which discriminated.[39]

In *Green v. Connally*,[40] the district court issued a permanent injunction against granting these tax benefits to racially segregated private schools on the ground that such benefits were inconsistent with federal policy. The court declined to make a constitutional determination but did predict the unconstitutionality of such tax benefits. The court seemed to assume that any direct aid would be unconstitutional "state action" under

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33. 309 F. Supp. 1127 (D.D.C.) (three-judge court), *appeal dismissed*, 398 U.S. 956 (1970).

34. *See* text accompanying note 29 *supra*.

35. 309 F. Supp. at 1134.

36. *Id.* at 1136.

37. 323 F.2d 959 (4th Cir. 1963). *See* note 21 *supra*.

38. 309 F. Supp. at 1136.

39. The *Green v. Kennedy* decision prompted the comment:

> [T]he court then declared that the Fifth Amendment forbids the federal government from aiding private discrimination . . . [but] stopped short of the conclusion . . . that tax exemption of private, segregated schools was unconstitutional, resting its decision on the proposition that the federal government should not frustrate the efforts of state governments to adhere to the Constitution.

Spratt, *supra* note 21, at 8. *See* Note, *Can Federal Tax Benefits Constitutionally Be Extended to Private Segregated Schools? The Implications of Green v. Kennedy*, 24 SW. L.J. 705, 710 (1970), in which the author stated that such constitutional determination would be a step in the right direction.

After this decision, the IRS announced that it could no longer legally justify tax benefits to discriminatory private schools. IRS News Releases, July 10 & 19, 1970, 7 CCH 1970 STAND. FED. TAX REP. ¶¶ 6790, 6814.

40. 330 F. Supp. 1150 (D.D.C.) (three-judge court), *aff'd sub nom.* Coit v. Green, 404 U.S. 997 (1971).

the fifth amendment.[41] The first case to hold that such tax benefits to discriminatory organizations were a fortiori impermissible "state action" in violation of the fourteenth amendment was *Pitts v. Wisconsin Department of Revenue*.[42] *Pitts* construed a Wisconsin statute which "confer[red] special advantages in the form of preferential tax treatment . . . [on certain organizations] which discriminate in their membership on the basis of race . . . ."[43]

In considering whether the granting of a tax deduction constituted "state action," the *McGlotten* court found it necessary to consider more than the substantiality of benefits and the causal relationship to the discrimination because "[e]very deduction in the tax laws provides a benefit to the class who may take advantage of it."[44] The nature of the governmental activity providing the benefit had to be considered when employing the sifting and weighing test of *Burton*. Since the Government, by means of statutes, regulations, and administrative rulings, had defined "in extensive detail not only the purposes which will satisfy the statute, but the *vehicles* through which these purposes may be achieved . . . [it] has marked certain organizations as 'Government Approved' . . ."[45] so that they may solicit funds from the public on the basis of that approval. The *McGlotten* court reasoned that this governmental approval was the same type given by the state in *Burton*. The *Burton* Court, applying the sifting and weighing test,[46] had found that the state, by leasing space in its parking lot to a private restaurant, had "elected to place its power, property and prestige behind the admitted discrimination"[47] and that, therefore, the discrimination by the restaurant had become "state action" violative of the fourteenth amendment. Thus, by appearing to stamp its

41. Clearly the Federal Government could not under the Constitution give direct financial aid to schools practicing racial discrimination. But tax exemptions and deductions certainly constitute a Federal Government benefit and support. While that support is indirect, and is in the nature of a matching grant rather than an unconditional grant, it would be difficult indeed to establish that such support can be provided consistently with the Constitution.

. . . .

We think the Government has declined to provide support for, and in all likelihood would be constitutionally prohibited from providing tax-exemption-and-deduction support for, educational institutions promoting racial segregation.

. . . .

Our decree will have no declaration of constitutional rights, but rather a declaration that the Internal Revenue Code requires a denial of tax exempt status and deductibility of contributions to private schools practicing racial discrimination.

Id. at 1164-65, 1169, 1171.

42. 333 F. Supp. 662 (E.D. Wis. 1971).

43. *Id.* at 670.

44. 338 F. Supp. at 456.

45. *Id.* (emphasis supplied by court). The court further stated:

The rationale for allowing the deduction of charitable contributions has historically been that by doing so, the Government relieves itself of the burden of meeting public needs which in the absence of charitable activity would fall on the shoulders of the government.

Id. *See* Lewis, *The Meaning of State Action,* 60 COLUM. L. REV. 1083, 1107-08 (1960).

46. *See* note 15 and accompanying text *supra.*

47. 365 U.S. at 725.

imprimatur on the private action, the state had become sufficiently involved to call forth the equal protection requirements.

It would seem that the governmental approval is even more significant in the instant case since, in *Burton,* the restaurant could have leased space elsewhere without the aid of the government. In *McGlotten,* however, the organization could not have avoided the taxes unless the Government specifically gave it the means to do so — exemptions.

> The public nature of the activity delegated to the organization in question, the degree of control the Government has retained as to the purposes and organizations which may benefit, and the aura of Government approval inherent in an exempt ruling by the Internal Revenue Service, all serve to distinguish the benefits at issue from the general run of deductions available under the Internal Revenue Code.[48]

Other deductions, such as trade or business expenses, net operating loss carryovers and carrybacks, income averaging and personal exemptions, were distinguished as "attempts to provide for an equitable measure of net income . . . [or] part of the structure of an income tax based on ability to pay . . . [or that the] provisions go no further than simply indicating the activities hoped to be encouraged . . . [without] having the imprimatur of the Government."[49]

The *McGlotten* court reasoned that the Government is providing no monetary benefit but merely defining "income," because the only income exempted from the tax on nonprofit clubs is the "exempt function income"[50] which includes income derived from members and income set aside for certain designated purposes.[51] This is part "of defining appropriate subjects of taxation."[52] Congress had decided that no tax should be placed on this type of organization as an entity for this type of income because no income of the type generally taxed is generated. The same people, the members, still have the beneficial use of the money but as an entity, rather than individually. It is merely a pooling of income rather than a production of additional income. Notably, however, any additional income generated from exempt function income would not be tax-exempt.[53]

The court also felt there was no mark of government approval inherent in this exemption so as to bring it within the *Burton* rule because the Code was not limited in coverage to particular activities but exempted clubs organized for nonprofit purposes in general.[54] Since the Government was

48. 338 F. Supp. at 457.
49. *Id. See* Note, *supra* note 27, at 938.
50. INT. REV. CODE of 1954, § 512(a)(3)(A).
51. *Id.* § 512(a)(3)(B).
52. 338 F. Supp. at 458.
53. § 501 exempts nonprofit clubs from taxation other than that imposed at corporate rates on unrelated business income by § 511. Section 512(a)(3)(A) defines the unrelated business income of §501(c)(7) nonprofit clubs as their "gross income," thereby including passive investment income. *Id.* at 458 n.49.
54. INT. REV. CODE of 1954, § 501(c)(7).

giving these clubs neither a monetary benefit nor its imprimatur, there was no "state action" and this exemption was thus constitutionally permissible.

The exemptions granted to fraternal orders, however, were of a different nature and, therefore, required a different result. The exemption applied to "passive investment income," which was income derived from funds provided by members and invested to benefit those members.[55] The court felt that this exemption could not be explained by defining the appropriate entity to be taxed.[56] Here, the money was not merely "shifted from one pocket to another, both within the same pair of pants."[57] Rather, new income was being generated and the exemption was considered a *benefit*. In addition, this exclusion was only given to:

> [P]articular organizations with particular purposes. . . . By providing differential treatment to only selected organizations, the Government has indicated approval of the organizations and hence their discriminatory practice, and aided that discrimination by the provision of federal tax benefits.[58]

Therefore, both government benefits and government approval were conferred on discriminatory fraternal orders, and, according to the court, either would have been sufficient federal involvement with the private organization to constitute "state action" violative of the fifth amendment.[59]

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55. 338 F. Supp. at 459.
56. *Id.*
57. *Id.* at 458.
58. *Id.* at 459.
59. *Id.* A recent Supreme Court decision, Moose Lodge v. Irvis, 407 U.S. 163 (1972), may indicate that *McGlotten* is destined to be reversed. The Court held that Pennsylvania's issuance of a liquor license to the Moose Lodge was not sufficient state action to violate the fourteenth amendment. Irvis, a Negro guest of a member, was denied service at the lodge. He brought suit for injunctive relief to have the lodge's liquor license revoked. The district court found for the plaintiff, but the Supreme Court reversed, holding that the lodge's refusal to serve a guest, because he was a Negro, did not violate the fourteenth amendment. *Id.* at 171–72. Mr. Justice Rehnquist explained the majority's position:

> The Court has never held, of course, that discrimination by an otherwise private entity would be violative of the Equal Protection Clause if the private entity receives any sort of benefit or service at all from the State, or if it is subject to state regulation in any degree whatever. Since state-furnished services include such necessities of life as electricity, water, and police and fire protection, such a holding would utterly emasculate the distinction between private as distinguished from State conduct . . . . Our holdings indicate that where the impetus for the discrimination is private, the State must have "significantly involved itself with invidious discriminations," *Reitman v. Mulkey*, 387 U.S. 369, 380 (1967), in order for the discriminatory action to fall within the ambit of the constitutional prohibition.

Id. at 173. Justice Rehnquist distinguished *Burton* on the facts: the land was privately, not state-owned; the lodge held itself out as a private, not a place of public accommodation; and it did not provide "a service that would otherwise in all likelihood be performed by the State." *Id.* at 175. These distinctions would obviously apply to the Elks as well as to the Moose. A further distinction was that the Pennsylvania Liquor Control Board did not play any part in establishing or enforcing the membership or guest policies of the lodge. *Id.* The Board's regulations, however detailed, were held not to "foster or encourage racial discrimination" nor make the state "a partner or even a joint venturer . . . ." *Id.* at 176–77.

It would seem that the Internal Revenue Service does no more to foster or encourage discrimination in its tax policies. Nevertheless, there still may be a distinction in that there is little which is as inherently an act of government as the

The court distinguished the Supreme Court's holding in *Walz v. Tax Commission*,[60] that tax exemptions were not sufficient government involvement to violate the first amendment, and noted that, although the first amendment establishment clause allowed benevolent neutrality, the fourteenth amendment required "a strict rather than a benevolent neutrality."[61] Thus, while tax benefits may be insufficient governmental entanglement to violate the first amendment, they are sufficient governmental aid to fall within the scope of the prohibitions of the fifth and fourteenth amendments.[62]

The court also decided that an overwhelming public policy required, even absent the constitutional prohibitions, that the Code be interpreted so as not to grant tax deductions for contributions to segregated fraternal orders.[63] Referring to *Green v. Connally*,[64] where the court had held that "[c]ongressional intent in providing tax deductions and exemptions is not construed to be applicable to activities that are . . . contrary to public policy,"[65] the court reasoned that the public policy as expressed in the thirteenth amendment and the Civil Rights Act of 1964 was clearly against discrimination and that, therefore, the Code could not be construed so as to allow these deductions.[66]

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imposition of taxes. Whenever such an act is done in a discriminatory manner, it would seem that the Constitution has been violated. Perhaps taxation is the outer limit of the state action doctrine, and liquor control, an act not necessarily done by the state, lies on the other side of the hazy boundary. Either a reversal or an affirmance of *McGlotten* could logically follow from *Moose Lodge*.

Justices Douglas and Brennan dissented. Justice Douglas cited the "complete and pervasive" scheme of regulation and the scarcity of liquor licenses as a restriction on the opportunity for Negroes to obtain liquor. Justice Brennan cited the continual supervision of almost every detail of the business. *Id.* at 179, 184. Neither Justice expressed the opinion that the mere issuance of the license by the state was sufficient "state action" or that it branded the discrimination with the apparent imprimatur of the state. It could thus be argued that the mere issuance of any type of license by the state, without more, to any discriminatory private entity, is not "state action." Whether a mere tax benefit, without more, will be deemed "state action" remains to be seen.

If *Moose Lodge* is deemed controlling and *McGlotten* is reversed, it would seem that Tank Truck Rentals, Inc. v. Commissioner, 356 U.S. 30 (1958) (*see* note 66 *infra*), must be overruled, because the impact of civil rights legislation would be reduced by the retention of income tax benefits. Deductions for the discriminatory organizations would frustrate national policies against such discrimination, a result seemingly inconsistent with the *Tank Truck* holding.

60. 397 U.S. 664 (1970), *noted in* 16 VILL. L. REV. 374 (1970).

61. 338 F. Supp. at 459 n.58. The court also referred to its discussion of the same issue in Green v. Connally.

62. *See* Note, *supra* note 27, at 939–40. The author suggested that tax benefits to religious schools would be permissible under the equal protection clause where grants of similar benefits to racially segregated schools would be impermissible because the issues must be resolved by the weighing of two different factors.

63. 338 F. Supp. at 460.

64. 330 F. Supp. 1150 (D.D.C. 1971).

65. *Id.* at 1161.

66. One author has said, in reference to segregated schools, that whether or not the exemptions would directly violate the fourteenth amendment, it would not represent an accommodation between the tax code and declared public policy which is required by the *Tank Truck* doctrine. *See* Spratt, *supra* note 21, at 33. Basically, the doctrine would not permit deductions which frustrate national or state policies because such deductions have the effect of mitigating any sting from a penalty for violating that policy. The doctrine is based on the Supreme Court's decision in Tank Truck Rentals, Inc. v. Commissioner, 356 U.S. 30 (1958). *See* Spratt, *supra* note 21, at 24–33; Note, *supra* note 21.

Finally, the court held that tax benefits were federal financial assistance within the scope of Title VI of the Act[67] as defined in the Act and in the regulations promulgated thereunder, and thus violated the Act when given to organizations which discriminated. Title VI forbade discrimination against any person on the basis of race, color, or national origin under any program or activity receiving federal financial assistance. The Act defined federal financial assistance as "assistance to any program or activity by way of grant, loan, or contract other than a contract of insurance or guaranty."[68] The regulations, however, were much more extensive as to what constituted federal financial assistance. For instance, the regulations included within the definition: (1) grants and loans; (2) the grant or donation of federal property or interests therein; (3) "the detail of Federal personnel;" (4) the sale, lease, or permission to use federal property at reduced, nominal, or no consideration; and (5) "any Federal agreement, arrangement, or other contract which has as one of its purposes the provision of assistance."[69]

The court discovered nothing in the legislative history of the Act to indicate whether tax benefits were to be included within the definition.[70] Thus, the court considered the plain purpose of the statute to be controlling. Believing that purpose to be to eliminate discrimination in programs or activities benefiting from federal financial assistance and believing that distinctions as to the method of distribution of federal funds were immaterial,[71] the court held the provisions of the Code which gave benefits to discriminatory organizations to be contrary to that policy and thereby violative of the Act.[72]

The court then determined whether particular sections of the Code did, in fact, provide assistance. The deductibility of contributions to fraternal orders which discriminate was found to be federal financial assistance, since it:

> "[I]s a special tax provision not required by, and contrary to, widely accepted definitions of income applicable to the determination of the

67. No person in the United States shall, on the ground of race, color, or national origin, be excluded from participation in, be denied the benefits of, or be subjected to discrimination under any program or activity receiving Federal financial assistance.
42 U.S.C. § 2000d (1970). *See* Dunn, *Title VI, The Guidelines and School Desegregation in the South*, 53 VA. L. REV. 42, 45–48 (1967).

68. 42 U.S.C. § 2000d–1 (1970). The courts have found such assistance in many types of direct grants. *See, e.g.*, Shannon v. HUD, 436 F.2d 809 (3d Cir. 1970) (rent supplements); Gardner v. Alabama, 385 F.2d 804 (5th Cir. 1967), *cert. denied*, 389 U.S. 1046 (1968) (federally-assisted welfare programs).

69. *See, e.g.*, 7 C.F.R. § 15.2(g) (Supp. 1972); 28 C.F.R. § 42.102(c) (Supp. 1972); 45 C.F.R. § 80.13(f) (Supp. 1972).

70. Representative Celler, a leading congressional spokesman for the Act, indicated that "grant" was not intended to be limited only to direct grants of money. 110 CONG. REC. 2467 (1964). Federal agencies have also interpreted the word "grant" to apply broadly to both direct and indirect aid. *See* Annot., 7 A.L.R. FED. 548, 555 (1971). Note, *supra* note 22, at 430.

71. The court seems to have considered the wide variations in the regulations issued by federal agencies as to what is federal financial assistance. *See* note 69 and accompanying text *supra*.

72. 338 F. Supp. at 461.

> structure of an income tax." It operates in effect as a Government matching grant and is available only for the particular purposes and to particular organizations outlined in the Code.[73]

It was apparent to the *McGlotten* court that there was no difference between tax benefits and the provision of federal property at a reduced consideration. Additionally, the court held tax exemptions to nonprofit clubs *not* to be federal financial assistance basing its decision on the same reasoning it used to determine that they did not operate as a grant of federal funds and thus were not "state action."[74] Similarly, because the court felt such exemptions operated like a subsidy to fraternal orders, the exemptions operated as federal financial assistance and were in violation of the Act.[75]

The broad implication of the *McGlotten* analysis is that any tax benefit given to any private organization that discriminates on the basis of race is unconstitutional, against public policy, and violative of the Civil Rights Act of 1964. This is not to say that every tax exemption or deduction granted to such organizations is unconstitutional, but those that represent a benefit conferred on a particular organization or class of organizations — those that are more than a part of the statutory definition of income or an across-the-board benefit — can no longer be given to such organizations. Tax benefits are now recognized as within the financial aid–state action theory and as a mark of governmental approval, bringing them within the *Burton* rationale.

The court might have extended its decision to include all exemptions and deductions permitted by the Code, on the theory that they are all granted by the grace of the legislature and are thus benefits, regardless of the specific rationale behind each exemption or deduction. In this manner all exemptions and deductions would be "state action" and would fall within the scope of equal protection. The legislative policy on civil rights could then be more effective because more pressure would be placed on those whose actions were contrary to that policy.[76] Discrimination would become a very expensive luxury to an organization which lost all tax

73. *Id.* at 462.
74. *Id.* *See* text accompanying note 53 *supra.*
75. *Id.*
76. The *Tank Truck* doctrine (*see* note 66 *supra*) would be applicable regardless of the constitutionality of the tax benefits. Other means of preventing discriminatory private organizations from receiving tax benefits, regardless of the constitutionality of such tax benefits, could result from changes in the Internal Revenue Code. The definitions of organizations in section 501 could be changed so as to exclude all organizations which discriminate or section 503 could be changed so as to deny exemption to discriminatory organizations (a section 501 exemption is dependent upon non-denial under sections 502 or 503). However, since *Tank Truck* does not prohibit ordinary and necessary expenses as deductions even for an illegal business, it might be advisable to change the meaning of "ordinary and necessary" so as to specifically exclude the expenses of a discriminatory organization. Should such changes be deemed to have altered the tax from an "income" tax as required by the sixteenth amendment, Congress might levy an "excise" tax on such organizations to avoid the prohibitions against an unproportional "direct" tax as set forth in article I, section 9(4) of the Constitution.

benefits as a result of it. Since most people generally utilize some type of tax benefit to their advantage, the effects of *McGlotten* could have covered a much broader range of organizations than those that will, in fact, be affected by the holding.[77]

The *McGlotten* method of enforcing public policy could extend beyond discrimination to many other national policies. A policy against pollution could be aided by denying tax benefits to any corporation that discharged pollutants into the air or water. A policy against overpopulation could be encouraged by removing any dependency deductions beyond those for one or two children. Some might view such developments as an encroachment by the government into a private segment of our society. However, an appropriate response would be that an express policy of the government should be implemented to the fullest extent possible.

The problem of policing would be no greater than at present. Once an organization was found, by a method sufficient to meet the due process requirement, to be in violation of any national policy, it would not be able to utilize any exemptions or deductions in computing its tax payments. A subsequent hearing or court proceeding could be provided by which it could be removed from the list of violators and again be eligible for tax benefits. Although deductions for contributions made to nonprofit organizations violating public policy would be more difficult to police, that problem applies to any charitable deduction. Presently, when someone deducts a contribution to an organization, unless the return is audited, the IRS does not ascertain whether it has granted that organization charitable status.

The effects of *McGlotten* will probably fall hardest on the segregated private schools, many of which could not exist without contributions which may not be forthcoming without the incentive of an income tax deduction.[78] Removing such tax benefits could force many of these schools out of existence and provide, at least to some extent, more integration. Furthermore, it is quite likely that the rationale of this case will be applied to private schools, especially since much of the court's reasoning was based on the *Green* cases, both of which dealt with that very situation.[79] A school receiving tax benefits, especially in the form of deductions for contributions, receives the Government's imprimatur no less than a fraternal organization. Considering the sifting and weighing test and the vigorous policy against the racial segregation of schools, there would seem to be a more compelling reason for declaring unconstitutional tax benefits given to these private schools than for a similar holding for those tax benefits given to

77. An additional constitutional problem — the denial of equal protection to businesses not allowed their ordinary and necessary expense deductions — may arise. A possible solution, however, would change the definition of ordinary and necessary expenses to exclude expenses incurred in practices contrary to public policies.

78. The district court in Coffey v. State Educ. Finance Comm'n, 296 F. Supp. 1389 (S.D. Miss. 1969), said that the formation and operation of many new private schools was on the thinnest financial basis. *Id.* at 1392. *See* Green v. Kennedy, 309 F. Supp. 1127, 1134–36 (D.D.C. 1970).

79. *See* notes 35–41 and accompanying text *supra.*