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INCOME TAXATION

Denial of Tax Exempt Status for Racially Discriminatory Schools

*Bob Jones University v. U.S.,
103 S.Ct. 2017 (1983)*

I. INTRODUCTION

SINCE THE ADOPTION of the thirteenth, fourteenth, and fifteenth amendments to the United States Constitution,¹ the elimination of racial discrimination has been constitutionally mandated.² The focus of eliminating racial discrimination in education began with *Brown v. Board of Education*,³ and has resulted in the passage of numerous federal laws⁴ and the promulgation of executive orders by various Presidents.⁵ These laws and orders illustrate that the federal government is committed to eliminating racial discrimination in all areas, not only in education.

The extent to which the government may deny tax-exempt status in order to further its goal of eliminating racial discrimination is a question of paramount importance. The United States Supreme Court recently addressed this question in the case of *Bob Jones University v. U.S.*,⁶ a consolidated action which involved a conflict between two established public policies: racial equality and religious freedom. The Court held that this nation's policy of racial equality overrides any interest that an educational and religious institution may have in promoting racial discrimination.⁷

¹The thirteenth amendment outlawed slavery. The fourteenth amendment was designed to afford due process and equal protection of the laws. The fifteenth amendment guaranteed black men the right to vote. U.S. CONST. amend. XIII-XV.

²Although these amendments were adopted over a century ago, their enforcement has been inconsistent. For a discussion of the amendments and their history, see United States Comm'n on Civil Rights, *Civil Rights: A National, Not a Special Interest* (June 1981).

³347 U.S. 483 (1954).

⁴See, e.g., Civil Rights Act of 1964, Pub. L. No. 88-352, 78 Stat. 241 (codified, as amended, at 42 U.S.C. §§ 2000a-2000f (1976 & Supp. III 1979); Emergency School Aid Act, Pub. L. No. 95-561, Tit. VI, 92 Stat. 2252 (1978) (codified at 20 U.S.C. §§ 3191-3207 (Supp. III 1979)).

⁵See, e.g., Exec. Order No. 10,925, 3 C.F.R. 448 (1959-1963 Compilation); Exec. Order No. 11,246, 3 C.F.R. 339 (1964-1965 Compilation); Exec. Order No. 11,478, 3 C.F.R. 803 (1966-1970 Compilation); Exec. Order No. 12,067, 43 Fed. Reg. 28,967 (July 5, 1978).

⁶103 S.Ct. 2017 (1983).

⁷*Id.* at 2035.

II. HISTORY

Until 1970, private schools enjoyed tax-exempt status regardless of their racial admissions policies, under section 501(c)(3) of the Internal Revenue Code (“the Code”).⁸ In addition, the Internal Revenue Service (“IRS”) granted taxable deductions for contributions to such schools under section 170 of the Code.⁹

This tax-exempt status changed in July of 1970, when the IRS ruled¹⁰ that private schools which practice racial discrimination could no longer enjoy tax-exempt status under section 501(c)(3).¹¹ The IRS also concluded that gifts to such schools could not be treated as charitable deductions for income tax purposes under section 170.¹² Private schools were formally notified of this change in policy by the IRS in a letter dated November 30, 1970.¹³

On June 30, 1971, the IRS’ amended construction of the Tax Code was approved in *Green v. Connally*.¹⁴ *Green* involved a class action instituted by parents of black children attending public schools in Mississippi, to enjoin U.S. Treasury officials from allowing tax-exempt status and contributions deductions to private schools which discriminate. In upholding the IRS, the Federal District Court for the District of Columbia stated that the Code “can no longer be construed so as to provide to private schools operating on a racially discriminatory premise the support of the exemptions and deductions which Federal tax law affords to charitable organizations and their sponsors.”¹⁵

Prior to 1970, Bob Jones University¹⁶ (“Bob Jones” or “University”) en-

⁸I.R.C. § 501(c)(3) (1976). Section 501(c)(3) exempts the following organizations from taxation: “Corporations, and any community chest, fund, or foundation, organized and operated exclusively for religious, charitable, scientific, testing for public safety, literary, or educational purposes, or to foster national or international amateur sports competition” *Id.*

⁹I.R.C. § 170 (1976). Section 170(a) allows deductions for “charitable contributions.” Section 170(c) provides in pertinent part:

- (c) Charitable contribution defined. For purposes of this section, the term “charitable contribution” means a contribution or gift to or for the use of - . . .
- (2) A corporation, trust, or community chest fund, or foundation - . . .
 - (B) organized and operated exclusive for religious, charitable, scientific, literary, or educational purposes, or to foster national or international amateur sports competition, . . . or for the prevention of cruelty to children or animals

¹⁰This ruling followed *Green v. Kennedy*, 309 F. Supp. 1127 (D.D.C. 1970), *appeal dismissed sub nom. Cannon v. Green*, 398 U.S. 956 (1970). In *Green*, the District Court for the District of Columbia issued a preliminary injunction prohibiting the IRS from approving tax-exempt status (under §§ 501(c)(3) and 170) to “private schools operated on a racially segregated basis as an alternative to white students seeking to avoid desegregated public schools.” 309 F. Supp. at 1140.

¹¹Rev. Rul. 71-447, 1971-2 C.B. 230.

¹²*Id.*

¹³*Id.*

¹⁴330 F. Supp. 1150 (D.D.C. 1971), *aff’d sub nom. Coit v. Green*, 404 U.S. 997 (1971) (per curiam). After the *Green* decision, the IRS formalized the policy in several rulings of which the most relevant are Rev. Rul. 71-447, 1971-2 C.B. 230; Rev. Proc. 72-54, 1972-2 C.B. 834. The 1972 procedures were superceded in 1975 by Rev. Proc. 75-50, 1975-2 C.B. 587.

¹⁵330 F. Supp. at 1164.

¹⁶The University is a religious and educational institution which enrolls about five thousand students from kindergarten through college and graduate school. *Bob Jones*, 103 S.Ct. at 2022.

joyed tax-exempt status under section 501(c)(3).¹⁷ Following the *Green v. Kennedy* decision in 1970,¹⁸ however, the IRS notified the University that it intended to eliminate the tax-exempt status of private schools which practiced racial discrimination in their admissions procedures.¹⁹

Although the University has permitted unmarried blacks to enroll since May 29, 1975,²⁰ a disciplinary rule prohibits interracial dating and marriage.²¹ This rule constitutes an integral part of the admissions policy in that applicants engaged in an interracial marriage or known to advocate interracial marriage or dating are denied admissions.²²

Upon the revocation of its tax exempt status,²³ the University instituted this action in the United States District Court for the District of South Carolina.²⁴ The district court held in favor of Bob Jones but the Court of Appeals for the Fourth Circuit reversed,²⁵ stating that “certain governmental interests are so compelling that conflicting religious practices must yield in their favor.”²⁶ The court remanded the case to the district court with instructions to dismiss the University’s claim and to reinstate the government’s counterclaim.

A similar situation involved Goldsboro Christian Schools²⁷ (“Goldsboro”

¹⁷*Bob Jones*, 103 S.Ct. at 2023.

¹⁸See *supra* note 10.

¹⁹*Id.* The University’s tax-exempt status was officially revoked by the IRS on January 19, 1976, and was made effective as of December 1, 1970, the day after the University was formally notified of the change in IRS policy.

²⁰Until 1971 blacks were completely excluded in order to further the University’s belief that the Scriptures forbid interracial marriage and dating. Beginning in 1971 Bob Jones accepted applications from blacks married within their race but did not accept applications from unmarried blacks. *Bob Jones*, 103 S.Ct. at 2022-2023.

²¹*Id.* at 2023. The rule states:

There is to be no interracial dating.

1. Students who are partners in an interracial marriage will be expelled.
2. Students who are members of or affiliated with any group or organization which holds one of its goals or advocates interracial marriage will be expelled.
3. Students who date outside their own race will be expelled.
4. Students who espouse, promote, or encourage others to violate the University’s dating rules and regulations will be expelled.

Id.

²²*Id.*

²³In 1975, the University filed returns under the Federal Unemployment Tax Act for the period from December 1, 1970, to December 31, 1975. It subsequently paid a tax in the amount of \$21.00 on one employee for 1975. When the IRS denied the University’s request for a refund of the \$21.00, Bob Jones instituted this action. The Government counterclaimed for unpaid federal unemployment taxes for the taxable years 1971 through 1975, totalling \$489,675.59, plus interest. *Id.*

²⁴An organization facing loss of tax-exempt status may pay the tax and sue for a refund in federal district court or the Court of Claims following expiration of the statutory six-month waiting period. I.R.C. § 7422 (1976); 28 U.S.C. §§ 1346(a)(1) and 1491 (1976).

²⁵*Bob Jones*, 639 F.2d 147 (4th Cir. 1981).

²⁶*Id.* at 154.

²⁷Goldsboro offers classes from kindergarten through high school and has satisfied the State of North Carolina’s requirements for secular education in private schools. *Goldsboro Christian Schools, Inc. v. U.S.*, 436 F.Supp. 1314, 1316 (E.D.N.C. 1977).

or “School”). Goldsboro maintains a racially discriminatory admissions policy based upon its interpretation of the Bible.²⁸ This interpretation requires the exclusion of blacks.²⁹ Unlike Bob Jones University, Goldsboro never had tax-exempt status under section 501(c)(3).³⁰ When the IRS audited the school for the years 1969-1972, it determined that Goldsboro was not an organization described in section 501(c)(3)³¹ and thus was required to pay taxes under the Federal Unemployment Tax Act³² and the Federal Insurance Contribution Act.³³

After paying the taxes with respect to one employee, Goldsboro filed a suit seeking a refund.³⁴ The school contended that it had been improperly denied tax-exempt status under section 501(c)(3).³⁵ The IRS filed a counterclaim for unpaid social security and unemployment taxes for the years 1969 through 1972, including interest and penalties.³⁶

On cross motions for summary judgment, the District Court for the Eastern District of North Carolina held that although Goldsboro’s admissions policy was based on a sincere religious belief, it precluded the school from qualifying as a corporation under section 501(c)(3).³⁷ The Court of Appeals for the Fourth Circuit affirmed and the Supreme Court granted certiorari in both *Goldsboro* and *Bob Jones* on October 13, 1981.³⁸

This note seeks to establish that the provisions of the Internal Revenue Code that exempt organizations from taxation are not applicable to religious schools such as Bob Jones and Goldsboro which discriminate on the basis of

²⁸Goldsboro believes that race is determined by descent from one of Noah’s three sons — Ham, Shem, and Japheth. Orientals and blacks are Hamitic, Hebrews are Shemitic, and Caucasians are Japhethitic. Mixing of the races is regarded as a violation of God’s command. *Bob Jones*, 103 S.Ct. at 2024 n.6.

²⁹Although Goldsboro’s interpretation of the Bible indicates the exclusion of all noncaucasians, the school has accepted noncaucasians but has never accepted blacks. Nevertheless, the district court assumed that the school’s racially discriminatory admissions policy is based upon a valid religious belief. *Goldsboro*, 436 F.Supp. at 1317.

³⁰*Bob Jones*, 103 S.Ct. at 2024.

³¹*Id.*

³²26 U.S.C. §§ 3101-3125 (1976).

³³26 U.S.C. §§ 3301-3311 (1976).

³⁴*Id.*

³⁵Goldsboro also claimed that it was not required to pay taxes on lodging furnished to its teachers. This issue, however, was not brought before the U.S. Supreme Court. *Bob Jones*, 103 S.Ct. at 2024 n.7.

³⁶The IRS originally counterclaimed for \$160,073.96, but because it did not begin enforcing its policy of denying tax-exempt status to racially discriminatory private schools until November 30, 1970, the IRS, by stipulation, agreed to abate its assessment for 1969 and most of 1970. The counterclaim was accordingly reduced to \$116,190.99. *Bob Jones*, 103 S.Ct. at 2024 n.8.

³⁷*Goldsboro*, 436 F.Supp. at 1320 (E.D.N.C. 1977).

³⁸After the Court granted certiorari, the Department of Justice submitted a memorandum to the Court on January 8, 1982, asking the Court to vacate the judgments in *Bob Jones* and *Goldsboro*. Since the Treasury Department had begun the process for revoking Revenue Ruling 71-447 and other rulings and regulations, the Government asserted that the two cases should be vacated as moot. Before the Court ruled on this motion, the Government was enjoined from granting or restoring tax-exempt status to racially discriminatory private schools in *Wright v. Regan*, No. 80-1124 (D.C. Cir. Feb. 18, 1982) (temporary order). After *Wright*, the government withdrew its request that the actions be dismissed as moot. *Bob Jones*, 103 S.Ct. at 2025 n.9.

race. In addition, the IRS' interpretation of the Code and its resulting actions did not constitute "legislating," nor did it violate the right of religious schools to freely exercise their religious tenets.

III. PUBLIC BENEFIT THEORY

Historically, charities have occupied a protected position in our community. As early as 1861 the United States Supreme Court announced that the "courts of chancery will sustain and protect . . . a gift . . . to public charitable uses, provided the same is consistent with local laws and public policy . . ." ³⁹ Since 1894, the federal income tax laws ⁴⁰ have provided an exemption for certain charitable organizations ⁴¹ because they serve desirable public purposes.

Bob Jones and Goldsboro argued that sections 501(c)(3) and 170 of the Code make any "charitable, religious or educational" organization tax-exempt regardless of its racial policies. ⁴² Although the Code does not explicitly mention racial discrimination, the Supreme Court analyzed sections 170 and 501(c)(3) and concluded that inherent in the Code is the intent that tax exemption depends on meeting "common law standards of charity." ⁴³ This means that before an institution can attain tax-exempt status it must serve a public purpose and not be contrary to public policy. ⁴⁴ Thus, religious and educational entities which violate public policy are not charitable and as such cannot be tax-exempt.

Since *Brown v. Board of Education*, ⁴⁵ it has become clear that racial discrimination in education is contrary to established public policy. ⁴⁶ The *Brown* holding is not limited to public education. In *Norwood v. Harrison*, ⁴⁷ the Supreme Court held that free textbooks are a form of tangible financial assistance benefitting public and private schools and as such cannot be provided to any school that practices racial discrimination. ⁴⁸ The Court also remark-

³⁹*Bob Jones*, 103 S.Ct. at 2027, (quoting *Perin v. Carey*, 24 How. 465, 501 (1861)).

⁴⁰Act of August 27, 1984, ch. 349, § 32, 28 Stat. 509, 556-557 (1894). For a list of these federal income tax laws which exempt certain charitable organizations see United States Comm'n on Civil Rights, *Discriminatory Religious Schools and Tax Exempt Status*, p.4, n.8 (December 1982).

⁴¹A common law definition of charity is found in *Ould v. Washington Hospital for Foundlings*, 95 U.S. 303 (1877): "A charitable use, where neither law nor public policy forbids, may be applied to almost any thing that tends to promote the well-doing and well-being of social man." *Id.* at 311. See also RESTATEMENT (SECOND) OF TRUSTS § 374 comment f at 258 (1959); and Simon, *The Tax-Exempt Status of Racially Discriminatory Religious Schools*, 36 TAX L. REV. 477, 483-500 (1981).

⁴²*Bob Jones*, 103 S.Ct. at 2025.

⁴³*Id.* at 2026.

⁴⁴*Id.*

⁴⁵347 U.S. 483 (1954).

⁴⁶Despite the 1954 announcement in *Brown*, segregation in public schools continued and an alternative system of private, segregated schools was established. For a discussion concerning the tactics utilized by the South to impede the desegregation process see generally, Note, *Segregation Academies and State Action*, 82 YALE L.J. 1436 (1973), and Comment, *The Private, Racially Segregated, Sectarian School*, 29 MERCER L. REV. 1099 (1978).

⁴⁷413 U.S. 455 (1973).

⁴⁸*Id.* at 469.

ed that “discriminatory treatment exerts a pervasive influence on the entire educational process.”⁴⁹

Racial discrimination in private education was also addressed in *Runyon v. McCrary*.⁵⁰ *Runyon* involved a civil rights action by parents of black children who were denied admission to private schools solely on the basis of race. In construing 42 U.S.C. § 1981,⁵¹ the Supreme Court held that racial discrimination in admissions to private, nonsectarian schools is unlawful.⁵²

In light of these decisions it is evident that the racially discriminatory admissions policy of Bob Jones University and Goldsboro Christian Schools neither furthers an established public policy nor confers a public benefit. This is so even though the schools’ policies are based upon a sincere religious belief.⁵³

IV. AUTHORITY OF IRS

Even if the IRS was correct in concluding that racial discrimination in private schools violates public policy, Goldsboro and Bob Jones argued that the IRS did not have the authority to issue its 1970 and 1971 rulings.⁵⁴ Both institutions alleged that the IRS “legislated” for Congress because the rulings altered the scope of the Code.⁵⁵

Although not specifically mandated, the power of the IRS to construe the Internal Revenue Code has been sanctioned by the Supreme Court in a long line of precedents.⁵⁶ Chief Justice Burger, writing for the majority, noted that these precedents illustrate that the IRS has the duty to determine whether a particular organization is “charitable” for the purpose of sections 170 and 501(c)(3).⁵⁷ Burger concluded that coupled with this duty is the authority of the IRS to determine whether an organization’s activities are so contrary to public policy that it is unable to provide a public benefit worthy of tax-exempt status.

Justices Powell and Rehnquist did not concur in the majority’s conclusion concerning the authority of the IRS. Although Justice Powell concurred with the Court’s judgment, he was bothered by the “broader implications of

⁴⁹*Id.* (citation omitted).

⁵⁰427 U.S. 160 (1976).

⁵¹42 U.S.C. § 1981 (1976) provides: “All persons within the jurisdiction of the United States shall have the same right in every State and Territory to make and to enforce contracts, to sue, be parties, give evidence, and to the full and equal benefit of all laws . . . as is enjoyed by white citizens . . .” *Id.*

⁵²427 U.S. 160 (1976).

⁵³103 S.Ct. at 2030. In order to determine whether given activities provide a public benefit, contemporary standards must be used. See *Walz v. Tax Commissioner of New York*, 397 U.S. 664 (1970).

⁵⁴For a brief discussion concerning these rulings see *supra* text accompanying notes 8-24.

⁵⁵*Bob Jones*, 103 S.Ct. at 2031.

⁵⁶*Id.* (citing *Commissioner v. Portland Cement Co.*, 450 U.S. 156, 169 (1981); *U.S. v. Correll*, 389 U.S. 299, 306-307 (1967); *Boske v. Comingore*, 177 U.S. 459, 469-470 (1900)).

⁵⁷*Id.*

the Court's opinion. . . ."⁵⁸ Justice Rehnquist dissented because the "Court should not legislate for Congress."⁵⁹

Both sides used the inaction of Congress to support their viewpoint. Chief Justice Burger stated that Congress' failure to modify the IRS rulings of 1970 and 1971 demonstrates "legislative acquiescence in and ratification by implication. . . ."⁶⁰ Justice Rehnquist, on the other hand, believed that Congress' inaction does not mean that it has approved the rulings.⁶¹ According to Justice Rehnquist, the IRS, in so construing the Code, overstepped its boundary and disregarded its limits of authority as established by Congress.

Although Justice Rehnquist's concerns are valid, his reasoning is shallow. As a practical matter, the IRS must be permitted to interpret the Code, with which it works every day and whose day to day operation Congress is inherently unable to oversee.⁶² Although Congress created the Code, only the IRS can effectively implement it.

Justice Rehnquist also argued that section 501(c)(3) does not contain a requirement that an entity first provide a public benefit before it can be given tax-exempt status.⁶³ Because of this, he concluded that an organization, so long as it fits within section 501(c)(3), can be given tax-exempt status regardless of its admissions policy.

Judge Hall, author of the Fourth Circuit decision in *Bob Jones*, would characterize Justice Rehnquist's analysis as "simplistic" because it tears section 501(c)(3) "from its roots."⁶⁴ The landmark case of *Green v. Connally*⁶⁵ is especially useful in this area. Judge Hall utilized the *Green* decision to state that section 501(c)(3) should not be separated from "its background in the law of charitable trusts."⁶⁶

Finally, one cannot ignore the congressional intent and legislative history concerning sections 170 and 501(c)(3). The *Bob Jones* Court pointed to congressional committee reports which insist that "discrimination on account of race is inconsistent with an educational institution's tax-exempt status."⁶⁷

⁵⁸*Id.* at 2036 (Powell, J., concurring).

⁵⁹*Id.* at 2045 (Rehnquist, J., dissenting) (footnote omitted).

⁶⁰*Id.* at 2033.

⁶¹*Id.* at 2044 (Rehnquist, J., dissenting). Congressman Ashbrook, who introduced an amendment limiting enforcement procedures for determining whether a school operated in a racially nondiscriminatory manner, stated that, "[t]he IRS has no authority to create public policy." In the same debate, Congressman Grassley declared that racial discrimination should not receive preferred tax status. *Bob Jones*, 103 S.Ct. at 2044 (Rehnquist, J., dissenting), (quoting 125 Cong. Rec. H5879-80 (daily ed. July 13, 1979)).

⁶²*Bob Jones*, 103 S.Ct. at 2031.

⁶³*Id.* Section 501(c)(3) is found, in part, *supra* at note 8.

⁶⁴*Bob Jones*, 639 F.2d at 151.

⁶⁵For a brief discussion of the *Green* decision, see *supra* text accompanying notes 14-16.

⁶⁶*Bob Jones*, 639 F.2d at 151.

⁶⁷*Bob Jones*, 103 S.Ct. at 2034, (quoting S. REP. NO. 1318, 94th Cong., 2d Sess., at 7-8 and n.5 (1976); H.R. REP. NO. 1353, 94th Cong., 2d Sess., at 8 and n.5 (1976)).

V. FIRST AMENDMENT CONCERNS

The first amendment to the United States Constitution states that "Congress shall make no law respecting an establishment of religion, or prohibiting the free exercise thereof."⁶⁸ Bob Jones and Goldsboro argued that the IRS' interpretation of sections 170 and 501(c)(3) violated their rights under the first amendment. The schools asserted that the denial of tax benefits penalized their right to freely practice their religious beliefs.

The Constitution permits parents to enroll their children in private educational institutions.⁶⁹ It also allows governmental assistance to private schools where public schools also receive assistance.⁷⁰ Nevertheless, the Constitution does not allow, nor should it tolerate, state aid to private schools which practice racial discrimination.⁷¹

Denial of tax benefits is a strong measure and will have a significant impact upon private religious schools.⁷² This does not mean that these schools will be unable to practice their credences.⁷³ It simply means that they will be unable to have tax-exempt status so long as they adhere to religious tenets which promote racial discrimination.

The *Bob Jones* Court employed a balancing test and found that since the governmental interest in preventing racial discrimination is "compelling," it "substantially outweighs whatever burden denial of tax benefits places on petitioners' exercise of their religious beliefs."⁷⁴ The strong national interest in promoting racial equality overrides any interest that a religious institution may have in exercising beliefs which discriminate on the basis of race.

CONCLUSION

By denying tax-exempt status to schools which practice racially discriminatory admission policies, the IRS hopes to further a national goal of nondiscrimination in all areas. Since education occupies an especially protected position in our society, it is axiomatic that where education is involved, racial discrimination must not exist.

Although the courts should discourage nonlegislative bodies from legislating, they cannot deny the IRS the right to *interpret* the tax laws. The IRS successfully avoided the frustration of established federal policies by its

⁶⁸U.S. Const. amend. I.

⁶⁹*Pierce v. Society of Sisters*, 268 U.S. 510 (1925).

⁷⁰*Committee for Public Education and Religious Liberty v. Regan*, 444 U.S. 646 (1980).

⁷¹*Norwood v. Harrison*, 413 U.S. 455 (1973).

⁷²*Bob Jones*, 103 S.Ct. at 2035.

⁷³*Id.*

⁷⁴*Id.* In order to avoid Free Exercise problems, the law must (1) have a secular legislative purpose, (2) which neither enhances nor inhibits religions, and (3) avoids excessive entanglement with religion. *Bob Jones*, 436 F.Supp. at 1320, (citing *Lemon v. Kurtzman*, 403 U.S. 602 (1971) and *Gillette v. U.S.*, 401 U.S. 437 (1971), *rehearing denied sub nom.* *Negre v. Larsen*, 402 U.S. 934 (1971)).

interpretation of sections 501(c)(3) and 170. The *Bob Jones Court*, by supporting the IRS, strengthened this nation's commitment to nondiscrimination.

The denial of tax exemptions is not an unduly harsh penalty, and it appears unlikely that schools such as Bob Jones and Goldsboro will be forced to close their doors. Nevertheless, *Bob Jones* will prove to be an important triumph for racial equality. Religious organizations can no longer cloak their prejudices in the first amendment and expect to receive tax exemptions from the government. The effects of *Bob Jones* will have broad implications in other contexts where institutions claim that their religious freedom allows them to engage in racial discrimination.

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