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Jerome Kurtz

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DIFFICULT DEFINITIONAL PROBLEMS IN TAX ADMINISTRATION: RELIGION AND RACE†

JEROME KURTZ*

Of all the interpretative judgments the Internal Revenue Service must make in administering the tax laws, probably none is more difficult and none demands more sensitivity than those concerning tax consequences affected by questions of religion and civil rights. These questions are far afield from the more typical tasks of tax administrators—determining taxable income. Nevertheless, our tax law places the IRS near the forefront in making delicate decisions involving definitions of “religion” and “church” and also places on the Service a substantial responsibility in making determinations relating to racial discrimination.

I'd like to discuss briefly why we must take positions in these areas and the factors considered by the Service in attempting to resolve these problems.

Statutory terms involving religion are found throughout the Code. Significant tax benefits follow from a determination that an organization is a “religious sect.” For example, under I.R.C. § 1402(g) it is exempt from payment of Social Security taxes. Donations made to a group “organized and operated exclusively for religious . . . purposes” under section 170(c)(2)(B) qualify for deductions at higher limits.

Moreover, churches today have only minimal demands made on them by the Service. For example, they are not required to seek exemption, they have no filing requirements, and they receive the benefit of the restraints imposed on the Service prior to an audit by section 7605(c).

Fundamental to most (but not all) of these usages in the Code is: (1) the characterization of an organization's purposes as “religious” as that term is used in section 501(c)(3); and (2) qualification of an organization as a “church.”

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* Commissioner of Internal Revenue Service

All of government—including the IRS—is constrained in the largest context by the First Amendment's Free Exercise and Establishment Clauses. In the Supreme Court's words, religious exercise must be permitted "to exist without sponsorship and without interference." *Walz v. Tax Commission*, 397 U.S. 664, 669 (1970). Exemption of religious institutions, whether from property or income taxes, has been characterized by the Court as representative of a "benevolent neutrality towards churches and religious exercise generally" that is "deeply imbedded in the fabric of our national life." *Id.* at 676-77. In addition to the constraint implicit in neutrality, government must ensure as well that the effect of otherwise appropriate decisions does not result in an "excessive entanglement" with religion.

The most fundamental perception we have of our role then is to administer these provisions with unimpeachable neutrality, using as our premise Justice Douglas' eloquent phrase that this society will "make room for as wide a variety of beliefs and creeds as the spiritual needs of man deem necessary." *Zorach v. Clausen*, 343 U.S. 306, 313-14 (1952).

Having said that, however, does not mean that these first amendment rights are absolutes or can be asserted as a screen for any kind of conduct. While the Court has found within the religious clauses of the first amendment both a freedom to believe and a freedom to act, it has also found that the former is absolute while the latter is not. *Reynolds v. United States*, 98 U.S. 145 (1878).

The Service, of course, has no concern with an individual's privately held beliefs, but it cannot always avoid concern with actions based on such beliefs. When a group makes its beliefs and programs a basis for seeking preferential tax treatment, then the Service has an obligation to inquire whether such preferences should appropriately be extended to such group.

From this distinction, the Service has constructed the first of two basic inquiries it makes of an individual or organization seeking to meet the "religious purpose" test of section 501(c)(3): Are the practices and rituals associated with the belief or creed illegal or contrary to clearly defined public policy? If a group's actions, as contrasted with its beliefs, are contrary to well established and clearly defined public policy, then tax preferences are inappropriate. The group will fail to meet the religious purpose test because "religious purpose" implies the absence of activities which are illegal or harmful in an important way to others. Under this test the Service revoked an exemption granted for ostensibly conventional charitable and religious purposes when we learned the group was actually organized to carry out a vicious, anti-semitic campaign.

The second inquiry, which is rather limited, is whether the particular belief is truly held. The Supreme Court ruled more than a generation ago that citizens may not be put to the proof of their religious doctrines or beliefs:

The Fathers of the Constitution were not unaware of the varied and extreme views of religious sects, of the violence of disagreement among them, and of

the lack of any one religious creed on which all men would agree. They fashioned a charter of government which envisaged the widest possible toleration of conflicting views. . . . The religious views espoused by respondents might seem incredible, if not preposterous, to most people. But if those doctrines are subject to trial before a jury charged with finding their truth or falsity, then the same can be done with the religious beliefs of any sect.

United States v. Ballard, 322 U.S. 78, 87 (1943). Nevertheless, the Court did hold that to enjoy a benefit based on a religious belief, the belief must be truly and sincerely held. This determination is tilted in favor of the applicant by the Service in this manner: in the absence of a clear showing that the beliefs or doctrines under consideration are not sincerely held by those professing them, the Service will not question the religious nature of those beliefs.

For example, within recent years the Service has ruled favorably on a sect that worshipped pagan deities. The members of the sect consider themselves pagans engaged in the practice of witchcraft, magic, healing, and clairvoyance. There was no evidence that the beliefs were not sincerely held and none of their activities violated any law or clearly-defined public policies. Their beliefs appeared to serve the same function in the lives of their adherents as the beliefs of a more conventional religion serve in the lives of its adherents, the "functional equivalence" test enunciated by a California appellate court some 20 years ago in upholding exemption for a secular humanist society. *Fellowship of Humanity v. County of Alameda*, 315 P.2d 394, 409-10 (1957).

Often associated with the determination of "religious purpose" is the question of whether the organization is a "church." For several reasons, more controversy has been generated in recent years about this part of the religion question than any other. Prior to 1970, all religious organizations and exempt organizations "operated, supervised or controlled by or in connection with a religious organization" were excused from virtually all accountability to the public. Congress, in the Tax Reform Act of 1969, narrowed the exceptions from filing an information return and indirectly attached greater significance to classification of an organization as a church or an integrated auxiliary of a church. Of less obvious significance than accountability, but of great practical consequence to qualifying as a church under section 170(b)(1)(A)(i), is the absence of the public support tests to avoid private foundation classification.

For many years, and now with increased frequency, the Service has been required to rule regularly and with far-reaching consequences on a term about which we have received almost no guidance from Congress. Frankly, it is a difficult and thankless task, but one that we cannot avoid because of the significant tax implications that follow when an organization qualifies as a church.

In determining whether an admittedly religious organization is also a church, the Service follows the principles enunciated by the court in *De La Salle Institute v. United States*, 195 F. Supp. 891 (N.D. Cal. 1961). In holding that a religious order operating schools and a novitiate was not a

“church,” and therefore not exempt from the tax imposed on unrelated income generated by a winery operated by the corporation, the Court was terse and direct:

To exempt churches, one must know what a church is. Congress must either define ‘church’ or leave the definition to the common meaning and usage of the word; otherwise, Congress would be unable to exempt churches. It would be impractical to accord an exemption to every corporation which asserted itself to be a church. Obviously Congress did not intend to do this.

Id. at 903. The Tax Court carried that concept further in *Chapman v. Commissioner*, 48 T.C. 358 (1967), when it determined that Congress used “church” more in the sense of a denomination or sect than in a generic or universal sense.

Consistent with these principles, the Service does not accept any and every assertion that an organization is a church. We have adopted a ruling position based on historical and practical considerations in arriving at what the Court in *De La Salle* called “the common meaning and usage” of the word “church.” As important as these historical and practical considerations, however, have been our attempts over the years to isolate and distill from authoritative judicial sources those indicia of the existence of a church that are the most objective and least involved with particular beliefs, creeds or practices. But beliefs and practices vary so widely that we have been unable to formulate a single definition. The determination whether a particular organization is a church must, therefore, be made on a case-by-case basis. It may be helpful to list the characteristics we utilize:

- (1) a distinct legal existence
- (2) a recognized creed and form of worship
- (3) a definite and distinct ecclesiastical government
- (4) a formal code of doctrine and discipline
- (5) a distinct religious history
- (6) a membership not associated with any other church or denomination
- (7) a complete organization of ordained ministers ministering to their congregations
- (8) ordained ministers selected after completing prescribed courses of study
- (9) a literature of its own
- (10) established places of worship
- (11) regular congregations
- (12) regular religious services
- (13) Sunday schools for the religious instructions of the young
- (14) schools for the preparation of its ministers

We are aware that few, if any, religious organizations—conventional or unconventional—could satisfy all of these criteria. For that reason, we do not give controlling weight to any single factor. This is obviously the place in the decisional process requiring the most sensitive and discriminating judgments. We are aware of this and that awareness is, perhaps, the best guarantee that we are trying to administer this difficult area carefully and evenly.

While I don't want to overstate the case, the alternatives to this admittedly imperfect process would weaken fundamental tax administration principles. Acceptance at face value of the assertion that an organization is a church would invite abuse. We must, for example, make preliminary determinations of bona fides in determining the application of section 7605(c) audit restraints.

A description of a current tax avoidance device illustrates the problem. Some individuals and organizations are marketing and promoting "plans" to avoid income taxes. While the "plans" vary in certain respects, a common theme calls for an individual taxpayer to obtain minister's credentials and a charter for a church or religious order by mail for a fee from churches that may or may not be recognized as exempt from federal income tax under I.R.C. § 501(c)(3). No profession of adherence to a creed, dogma, or moral code is required and no duties or fiduciary responsibilities are undertaken in order to receive and administer these charters or credentials.

The "plan" then calls for the individual to take a "vow of poverty" and to assign his assets (house, car, savings account, etc.) and the income earned from current employment to the purported church or order. A major portion of the income assigned to the church or order from this unrelated occupation is set aside for housing, food, clothing, and other items for the individual. Most of the remaining income is set aside for the upkeep of the premises in which he resides, the maintenance of the individual's car which is provided for his unrestricted use, and for occasional "spiritual retreats" by the individual to traditional vacation areas. Under the "plan," less than ten percent of the remaining assigned income is utilized for gifts to the poor, prayer books, bibles, and other church functions.

Typically, the solicitations conclude that a vow of poverty can make a person rich.

Those interested in protecting the preferences for churches must agree that the Service has an obligation to be vigorous in stopping such schemes.

We have been criticized for the scope and breadth of the criteria we use and it has been implied that the Service has been trying in recent years to discourage new religions and new churches. I can assure you that that is not the case with the IRS. But the protection of church preferences requires that such preferences not be distorted.

We will do our best to administer this difficult area with tact and discretion. We may err occasionally but I remind you that Treasury and the Service were among the most vigorous advocates of the declaratory judgment procedures for exempt organizations so that there would be prompt judicial resolution of disputed rulings.

Race

Equal in difficulty to the religious issues are those involving race. Again, the Service has been pulled from both directions, being criticized at the same time for doing too little and too much. Guidance on racial

issues is less clear than that on religious issues. We have only a little more than 25 years of history and development of the law and federal policy on school integration compared with 200 years of history on religious issues. We have almost no specific statutory guidance; our authority and obligations on racial issues derive from the constitutional doctrine announced in *Brown v. Board of Education*, 349 U.S. 294 (1954), and cases enforcing and interpreting it, and from the broad national policy announced in the Civil Rights Act of 1964.

Our policy and administration in this area is developing. As in the case of the religious issue, this is not an area with which tax administrators typically deal. Our experience is limited. We are, however, moving to fulfill our responsibility as promptly as we reasonably can. As I will relate in a moment, the Service has taken significant steps in recent years to improve compliance with its private school policy. We expect further guidance from the courts since we are presently involved in litigation about our enforcement program.

The most demanding tax administration problem for the Service is in determining whether private schools have adopted and implemented a racially non-discriminatory student admissions policy. While this is obviously not the only tax problem involving race, it is the one that has received most attention from the Service and its constituency in recent years. Service ruling policy is found in Revenue Rulings 71-447 and 75-231. Guidelines and procedures are found in Revenue Procedure 75-50. Essentially, these three documents deny tax exemption to private schools that discriminate in their admissions policy on the basis of race or ethnic origin. Church-related private schools are covered within this policy, as well as the churches that operate and control them.

These rulings' positions had their origins in the early part of this decade when a federal court enjoined the Secretary and the Commissioner from granting exemption to private schools in the State of Mississippi that discriminated on the basis of race in their admissions policies. The first ruling in this area extended a similar prohibition to all private schools in the United States. Schools were notified of this ruling and given an opportunity to adopt a suitable admissions policy and publicize it to the communities they served. More than 100 schools chose not to adopt such a policy, resulting in the revocation of their exemptions.

In 1975, the Service announced that that policy was equally applicable to schools operated or controlled by churches and, in the same year, issued Revenue Procedure 75-50 articulating important standards and guidelines by which both Service agents and the affected schools could determine whether the latter were in compliance. A brief background discussion about the evolution of these latest developments may be helpful.

In the fall of 1974 a Task Force composed of IRS and Chief Counsel personnel undertook to evaluate, in the broadest context, Service policy affecting private schools. They studied every part of the IRS responsibility, from rulings policy in the National Office to examination practices in the

field. They discovered what appears to be almost a truism: translating policies and guidelines about race into compliance and enforcement practices presented the Service with the most difficult kind of tax administration judgments. The basic charge to the Task Force was to prepare recommendations to give field agents specific and objective guidelines both in considering exemption applications and in conducting examinations of private schools. Within the past few weeks, the final item resulting from the Task Force's work has been issued to the field. In addition to the revenue rulings and procedures, our private school program includes the following:

- An internal management reporting system to record and track complaints, audit results, and exemption letter activity.

- Specific and detailed examination guidelines and a checksheet to assist field agents.

- A revised Schedule A to Form 1023 (Application for Exempt Status) to conform it to the informational requirements established by Revenue Procedure 75-50.

- A revised Form 990 to provide for the annual certification required by Revenue Procedure 75-50 that the school is complying with all aspects of the Revenue Procedure and to collect information to assist us in selecting private school returns for examination.

- Revised basic training materials for exempt organizations specialists to reflect the new guidelines.

Audit coverage of private schools has increased dramatically in the past two years. In fiscal year 1977, 784 private school returns were examined, representing approximately ten percent of the private schools with individual rulings in each Key District. That coverage includes a number of church-related private schools as well.

Notwithstanding that the Service is committed to removing tax exemption from schools that discriminate racially, and has devoted significant resources to ensure that its enforcement activity is equal to the task of assuring nondiscriminatory admissions policies, certain troublesome questions persist. One question is how we should evaluate the bona fides of the admission policy of schools located in communities subject to desegregation orders that operate over a long period of time without actually enrolling any minority students. Does that fact create a presumption calling for more careful scrutiny? Might a similar rule be applicable even in the absence of local desegregation orders? And, on the other side of that question, what steps can an exempt school take in such a situation to establish that it, in fact, has been open to children of all races and ethnic groups?

An equally serious question is whether and how far the issue of racial nondiscrimination extends beyond private schools to other exempt activities. Congress gave some intimations of its feelings on this question in 1976 when it added section 501(h) to the Code prohibiting certain social clubs from discriminating in their governing instruments on the basis of race, color, or religion.

Questions in this area are obviously sensitive and put the IRS, in some cases, on the cutting edge of developing national policy. But this is where we find ourselves and we will do our best.

I appreciate this opportunity to share with you some of our views on matters of as great concern to the Service as they are to the public we serve. [News Release, IR-1930.]