

# The Catholic Lawyer

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Volume 24  
Number 3 *Volume 24, Summer 1979, Number 3*

Article 5

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April 2017

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George E. Reed

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### Recommended Citation

George E. Reed (1979) "Revenue Ruling 77-290," *The Catholic Lawyer*. Vol. 24 : No. 3 , Article 5.  
Available at: <https://scholarship.law.stjohns.edu/tcl/vol24/iss3/5>

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# REVENUE RULING 77-290— VOW OF POVERTY

GEORGE E. REED, Esq.

Last year I had the unenviable task of reporting to this group on Rev. Ruling 77-323, which effectively rescinded a ruling which had been in existence since 1919. I refer specifically to Office Decision 119. It seems like I have lived with this problem for a long period of time.

When I came here as a young attorney in 1943, I went down to the Internal Revenue Service and told them that they had erroneously applied Office Decision 119. And they said, "No, we did not, we just repudiated it." So we worked a solid year and secured a new ruling in 1944, which reestablished O.D. 119 and which gave more extensive rationale underlying the meaning of O.D. 119, which specifically stated: "O.D. 119 exempted members of religious orders subject to a vow of poverty from the payment of income tax on revenue received by them as agents of their order."

I want to emphasize the term "agents." From the very beginning, O.D. 119 was predicated on an agency relationship. The briefs that were filed in 1943 were written on that basis. The 1944 letter ruling to the National Catholic Welfare Conference (now the USCC) was also predicated on the agency relationship. Things went along swimmingly until last year. Out of the blue Revenue Ruling 77-323 was promulgated, which for all practical purposes rescinded O.D. 119 and the 1944 letter ruling. Under it, all religious would be subject to the payment of income tax unless they were working for their own orders.

We asked for a conference with the Internal Revenue Service in September of 1976. IRS was not too eager to give us one, so we asked Treasury. We went to the Secretary and he set up a joint conference with the Internal Revenue Service in September of 1976. That particular conference was not too productive. There were, however, several results that came out of it. First, IRS agreed to permit us to file a brief. Father Whelan and I prepared a brief and we filed it on November 15. Secondly, during the conference they held that Revenue Ruling 68-123 was still viable. That is an important result. That was a situation where a member of a religious institute was working at a hospital which was not operated or controlled by her institute. Arrangements were made by the institute for her to work at that hospital. It was not a Catholic hospital, as I recall the situation, although the facts are not set forth in the ruling itself.

Internal Revenue Service ruled that the member of the institute was not subject to income tax or social security tax. This was the only agreement that we really arrived at as a result of the September conference, in

addition to the fact that we were given the opportunity of filing a brief. There were certain areas of disagreement which I think I should note because it does give us an insight into the attitude of Treasury, and particularly, IRS.

Treasury and IRS refused to exempt religious who are working for a public entity or for another 501 (c)(3) organization. For example, the question came up, "How about a religious who is teaching theology at Harvard?" They said, "No way, he would be subject to taxation." They even took the position that if he were a Dominican and he was working as a theology professor, in a Jesuit school, he would be subject to taxes. They said that a member of a religious order who was serving as the chaplain would be subject to income tax.

As a result of this conference, we filed our brief and we asserted several basic propositions: First, that any religious who is working within the structure of the Church is entitled to an exemption, that is, anyone who is working for an institution listed within the Official Catholic Directory would be entitled to an exemption. Secondly, that any religious who is working for a 501(c)(3) organization and is performing services that are comparable to the work he would perform in the structure of the Church would be entitled to exemption, provided, of course, that the religious order made the arrangements and exercised some supervision or control. We took the same position with respect to a religious working for a public agency, let's say a public school, under the same conditions. Nothing happened between November 15, 1976, when we filed our brief, and July 15, 1977. On that date we had another meeting.

The first meeting was in the offices of the Internal Revenue Service. The second meeting was in the offices of the Treasury, and it was chaired by representatives of the Treasury Department. Those meeting with us were John Nolan, who is, as you know, on our Tax Advisory Committee, Father Whelan, Jim Robinson, and myself. We spent about a whole afternoon discussing various aspects of this issue. They agreed in conference (1) that if a religious is working within the structure of the Church, or is working for an organization that is associated with the Church, then he would be entitled to an exemption. By "associated with" they were referring to organizations such as Georgetown University, or Fordham University where Father Whelan teaches, that have separate tax status but are basically Catholic organizations. They are not covered by the group ruling, but nevertheless they are generally known as Catholic institutions. There are many other issues which were discussed. IRS took a flat out position that religious working for the public school system would not be exempt. They took a position that religious working as chaplains would not be exempt. There were many other examples which were brought up in the area of 501(c)(3) organizations outside the structure of the Church. For example, public agencies were discussed at length.

When we pressed hard to get at least acceptance of the 501(c)(3) category and, to a certain extent, the public entity theory, the representative of the Treasury said, "If you may, insist that we be illogical, but don't

ask us to be impractical." It was obvious to us that Treasury was very definitely calling the shots in this, and it should, for it is a very important ruling. But both IRS and Treasury seemed to be of one mind on the general contours of the ruling. They were in agreement that 68-123 would continue to be a viable precedent. That is important. A couple of members of the IRS group tried to narrow 68-123 down by stating that this only applied when the religious was working in a hospital within the Catholic Church. The Treasury representative said, "We will interpret 68-123 as it is written, and as it is written there is no limitation on the type of hospital."

On August 15, about a month thereafter, the Rev. Ruling was published, Rev. Ruling 77-290. It superseded O.D. 119. It gave us some advantages over 76-123. The essence of the ruling is this: Where a member of a religious order is directed to perform services for another agency of the supervising church or an associated institution, the member will be considered an agent of the order. I want to emphasize one thing, a very important thing, as I see it. The ruling is not predicated on the nature of the work that is done. On the contrary, IRS is concerned with agency, not with religion. This was true in O.D. 119, it was true in 1944, and it appears to be true this year. No reference is made to 68-123 in this ruling.

On the day 77-290 was published I called the chief bargaining agent for IRS and I said, "I see nothing in here with respect to 68-123." He said, "It was in the previous ruling and we did not revoke the previous ruling so it is still applicable." I said, "Well, my recollection is also that shortly before the end of our conference I specifically asked whether this ruling would be prospective; that is, to the extent that it did not cover and did not provide protection for religious who were working for commercial concerns or outside the structure of the Church, it would not be retroactive?" I was informed in conference that it would be prospective, and I saw nothing in this ruling indicating that it was prospective. Ordinarily, when the ruling does not mention its prospective character, it is assumed that it is retroactive. He said, "We definitely intend that this should be prospective in operation. We stated in conference on the basis of your 1944 ruling that our hands were tied by our regulations and by our revenue procedures. We hold to that proposition that it is prospective."

We have had another meeting with IRS on this proposition. They have affirmed that it is prospective. Jack Myers can go into that a little later on.

A few more minutes on some of the implications of this revenue ruling. As we see it, it leaves many important questions unresolved. Moreover, there seems to be a valid basis for challenging its holding that certain members of religious orders are personally liable for social security tax. There is nothing in the Code or the regulations with respect to the gross income or compensation paid for services rendered by members of religious orders. But there are specific provisions with respect to social security taxes and withholding. IRS in this ruling has ignored those very basic statutory provisions. They have taken the position that if a religious is subject to income tax, he is subject to social security. I know from my

conversations with the Social Security Administration in Baltimore, that they do not go along with that, and are coming up with another ruling.

Finally, there is an advocacy position and Jack Myers will go into that more thoroughly. I am telling you precisely what occurred in the conference. I think what occurred in the conference will reflect the current attitude of Treasury and IRS. However, when you combine 77-290 and 68-123 the question arises: Why should a religious who works for a non-Catholic hospital be given a privilege which is not extended to a religious who works for Harvard University? Why the distinction between health and education? This is a problem which has not been resolved. I personally think that it is going to be very difficult to radically change this ruling because any technical advice must be sought principally from IRS. They are going to make the rulings with respect to expansion and contraction of this ruling. In any event, we have recouped approximately 80% of the loss which we sustained in 1976.