Seventh Circuit's Taxation of Members of Religious Orders - A Change of Habit

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The United States Constitution establishes the right of the federal government to raise revenues\(^1\) and the right of individuals to exercise their religious beliefs free from state interference.\(^2\) The inevitable interac-

\(^1\) U.S. Const. art. I, § 8, cl. 1. This section reads in pertinent part: "The Congress shall have Power To lay and collect Taxes . . . to pay the Debts and provide for the Common Defence and general Welfare of the United States . . . ." \textit{Id.}

\(^2\) U.S. Const. amend. X. The sixteenth amendment further expanded this "power": "The Congress shall have power to lay and collect taxes on incomes, from whatever source derived, without apportionment among the several States, and without regard to any census or enumeration." U.S. Const. amend. XVI.

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See \textit{Walz v. Tax Comm'n}, 397 U.S. 664, 669 (1970); \textit{Everson v. Board of Educ.}, 330 U.S. 1 (1947). In colonial America, groups such as Quakers, Protestants, and Catholics were forced to support governmentally sponsored churches. \textit{Everson}, 330 U.S. at 10. The first amendment sprang from the anger of these dissenters. \textit{Id.} at 11. Further, the colonial Americans formed a general conclusion that individual religious freedoms were best promoted when a government was without the power to support or aid religions. \textit{Id.}

James Madison, considered to have been instrumental in the drafting and adoption of the first amendment, believed:

[T]hat a true religion did not need the support of law; that no person . . . should be taxed to support a religious institution of any kind; that the best interest of a society
tion of these rights has resulted in the exemption of churches and religious organizations from federal taxation. Members of religious orders required that the minds of men always be wholly free; and that cruel persecutions were the inevitable result of government-established religions. Id. at 12.

Three interpretations of the first amendment were formulated. L. Tribe, American Constitutional Law § 14-3, at 816 (1978). The evangelical view, supported by Roger Williams, warned against excessive interactions by claiming that worldly corruptions might consume the unprotected churches. Id. at 817. The Jeffersonian view was concerned with the inundation of religious beliefs onto the secular interests of the state. Id. The "'wall of separation between Church and State'" was intended to prevent this. Everson, 330 U.S. at 16 (quoting Reynolds v. United States, 98 U.S. 145, 164 (1878)). The Madisonian view provided for the advancement of both religion and state through a diffusion and decentralization of power in order to reduce the likelihood of either's dominance by assuring competition. L. Tribe, supra, at 817.

The traditional approach used to assess Establishment Clause violations is a tripartite test espoused by the Supreme Court. See Lemon v. Kurtzman, 403 U.S. 602, 612-13 (1971). The three questions utilized by this test are: (1) whether the program has a secular purpose; (2) whether the primary effect is neither to advance nor inhibit religion; and (3) whether the legislation avoids "an excessive governmental entanglement with religion." See id. (quoting Walz, 397 U.S. at 674). If any prong is not met, an Establishment Clause violation exists. See id. at 613-14. See, e.g., Larkin v. Grendel's Den, Inc., 459 U.S. 116, 123 (1982) (secular purpose valid but statute unconstitutional because it primarily advances religion); Wolman v. Walter, 433 U.S. 229, 236 (1977) (despite secular purpose statute does not pass constitutional muster due to difficulty with effect and entanglement criteria); Meek v. Pittenger, 421 U.S. 349, 363 (1975) (if direct advancement resulted, impermissible establishment of religion resulted); see also Note, Mail Order Ministries, The Religious Purpose Exemption, and the Constitution, 33 Tax Law. 959, 975-76 (1980). The first prong of the Lemon test is rarely used to invalidate government programs; the second prong examines the effect of state action; and the third "poses the most rigorous of the three tests." See id. at 976-77.

3 See Walz, 397 U.S. at 676-80. One religion was not to be sponsored or aided by the tax exemption; it was applied to all religions. See id. at 672-73. The Walz Court also mentioned that the tax exemption had a history dating back to the first federal income tax. Id. at 676. Such an uninterrupted practice could not be "lightly cast aside." Id. at 678.

Although never articulated, it is thought that the tax exemption was granted to promote good will and because the churches provided benefits and services to society. See Note, supra note 2, at 973. It has been suggested that fostering the development of these benefits justifies the tax exemption. See id.

It has been further noted that religion cultivates a state's moral or mental improvement. See Mangrum, Naming Religion (and Eligible Cognates) in Tax Exemption Cases, 19 Creighton L. Rev. 821, 827 (1986). The Walz Court derived for the state "an affirmative policy that considers these groups as beneficial and stabilizing influences in community life and finds this classification useful, desirable, and in the public interest." Walz, 397 U.S. at 673.

The conclusion of the Walz Court, that tax exemption would contribute the least to excessive governmental entanglement, was premised on the theory that elimination of the exemption would expand government involvement by necessitating valuation of church properties, liens, and similar assessments. Id. at 674-75. See also B. Hopkins, The Law of Tax Exempt Organizations 168 (1983) (current state of law is that tax exemptions do not
who generate income as agents of their organizations were traditionally not subject to taxation. Conversely, income received as a result of services rendered in an individual capacity was deemed taxable. Recently in

violate first amendment). The Walz Court however, was careful not to base tax exemption on specific services or on charitable works the church took part in. See Mangrum, supra, at 827. This would produce entanglement and minimize neutrality, which would give rise to more confrontations. See Walz, 397 U.S. at 674.


The second group is comprised of members of religious orders working for charitable organizations, such as a hospital or a college, but not a church. See Wittenbach, supra, at 558. For a tax exemption, an agency relationship must be established. Id. A noted Revenue Ruling in this area concerned a nun who was a registered nurse working at a hospital. Id.; see Rev. Rul. 68-123, 1968-1 C.B. 35. She was deemed an agent of her order and her income was not taxed because she remained at all times subject to the order's control. See Rev. Rul. 68-123, 1968-1 C.B. at 35-36.

The third group is comprised of members of religious groups whose employment situations are classified as being "secular." Wittenbach, supra, at 558. Generally it is presumed that no agency exists. Id. As an added note, if an agency relationship is proven, the income will not be included in the income of the individual. Id. However, the religious order will be taxed under section 511 of the Internal Revenue Code as unrelated trade or business income. Id. at 558-59; see also Myers, Vow of Poverty Ruling, 24 Cath. Law. 221, 223 (1979) (IRS seems to break members into certain taxable and nontaxable categories).

* O.D. 119, 1. C.B. 82 (1919). The Official Decision reads in pertinent part: "Members of religious orders are subject to tax upon taxable income, if any, received by them individually, but are not subject to tax on income received by them merely as agents of the orders of which they are members." Id. See Rev. Rul. 77-290, 1977-2 C.B. 26, 27 (reiterates and espouses Office Decision 119 as still being valid law); Rev. Rul. 68-123, 1968-1 C.B. 35, 36 (as an agent of order, nun/nurse should not be taxed individually). See also 2 MERTENS, LAW OF FEDERAL INCOME TAXATION § 17.11, at 70 (J. Doheny ed. 1982) ("money received by a minister as agent for a church is not taxable to him"); Reed, Revenue Ruling 77-290 — Vow of Poverty, 24 Cath. Law. 217, 219 (1979) (IRS is concerned with agency, not with religion); Wittenbach, supra note 4, at 555 (agency relationship must be established by services performed for related church organization). But see Fogarty v. United States, 780 F.2d 1005, 1012 (Fed. Cir. 1986) (member of religious order is not ipso facto an agent for tax purposes); Kelley v. Commissioner, 62 T.C. 131, 138 (1974) (priest living as layman for personal reasons not acting as agent).

* Fogarty, 780 F.2d at 1012-13. The Federal Circuit court concluded that a priest who taught in a religious studies department of a university was properly taxed as an individual after a review of relevant factual indicia. Id. See Kelley, 62 T.C. 131. In Kelley, despite his vow of poverty, a priest acted as an individual considering he retained all his material possessions obtained during a short leave, and he was therefore properly taxed. Id. at 138. See also Macior v. Commissioner, 48 T.C.M. (CCH) 91, 93 (1984) (Franciscan Friar living in nonconformity with his vow of poverty received income as an individual); Reed, supra note
Schuster v. Commissioner, the Court of Appeals for the Seventh Circuit held that a nun's income for staff nurse-midwife services, although in furtherance of the objectives of the Order, was earned in an individual capacity, not as an agent of her Order, and was thereby taxable.

In Schuster, petitioner, Sister Francine Schuster, was a member of the Order of the Adorers of the Blood of Christ (the "Order"). Members of the Order were encouraged to secure work in occupations that furthered the general purposes of the Order. Members were also required to take vows of obedience, chastity, and poverty. To further her medical skills and her obligation to the Order, Sister Francine took part in a funded educational program, and upon completion was required to work

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5, at 217 (all members subject to payment of income tax unless working for their orders); Wittenbach, supra note 4, at 554 (discussing Rev. Rul. 77-290 and stating that one under vow of poverty can be taxed individually).

7 800 F.2d 672 (7th Cir. 1986)

* See id. at 678.

* See id. at 673. The Order was a Roman Catholic organization incorporated in 1886 in Illinois, as the Convent of the Sisters of the Precious Blood. Schuster v. Commissioner, 84 T.C. 764, 765 (1985), aff'd, 800 F.2d 672 (7th Cir. 1986). The Order is a tax exempt organization. Schuster, 800 F.2d at 673.

10 See Schuster, 800 F.2d at 673-74. The employment secured by the member was subject to ultimate approval by the Order. Id. The Order's approval was contingent upon whether the employment related to the purposes of the Order. Id. at 674. The purposes of the Order are:

[T]o conduct schools and places of learning and to promote education, to advance the cause of religious and social work, to conduct hospitals and institutions for the care and treatment of suffering humanity and to do all and everything necessary or convenient for the accomplishment of any of the purposes or objects and powers above mentioned or incidental thereto.

11 See id. at 673. Sister Francine executed a "Declaration Concerning Remuneration." Schuster, 84 T.C. at 765. Within this document she agreed "'never [to] claim or demand, directly or indirectly, any wages, compensation, remuneration, or reward... for the time or for the services or work that I devote for... [the Order] during the time I may remain there or elsewhere in the name of or upon commission from said [Order].'" Id. at 765-66. If Sister Francine wished to leave the Order, she would be permitted to take only the personal property she brought into the Order, as well as gifts and inheritances. Id. at 766. Furthermore, pursuant to the vow of poverty, a member was not allowed to keep any of the income earned during her employment. Id. She did not in any way control the money. Id.

When it was impractical for a member to live at the convent or the Mother House, a residence was rented for her. Id. at 767. A budget was prepared and, upon approval, the member was entitled to a stipend for living expenses that was in no way related to the earned income. Id. For the year at issue, Sister Francine received thirty-five dollars a month. Id.

Under the vow of obedience, a member was required to put the Order's will before hers. Id. at 766. She could not accept any employment without the express approval of the Order, and upon employment could not quit without approval. Id. Even in ordinary work situations, the member was subject to the Order's will. Id.

12 See Schuster, 800 F.2d at 674. Pursuant to section 822(b) of the Public Health Service
in a "health manpower shortage area." She secured employment with Su Clinica Familiar (the "Clinic") which was involved in an employment program administered by the National Health Services Corps ("NHSC"), a division of the United States Public Health Service. The Order approved her selection and sent correspondences to the NHSC and the Clinic concerning Sister Francine's services and requested that they be paid directly. The Clinic rejected the Order's request, noting that the checks would be made out to Sister Francine individually; the NHSC failed to respond at all. For the duration of her employment, Sister Francine endorsed each check over to the Order, pursuant to her vow of poverty. Sister Francine's 1980 income tax return reflected her wages but declared that she was exempt from taxation because of her affiliation with the Order. The Commissioner issued a notice of deficiency claiming

Act, an educational grant was bestowed upon Sister Francine to cover her tuition, books, fees, living, and moving expenses. Id. She attended the University of Mississippi Medical Center and participated in the Nurse Midwife Program. Id.

Id. This was for a twelve month period. Id. A "health manpower shortage area" is defined as "any of the following which the Secretary determines has a shortage of health manpower: (1) An urban or rural area . . . ; (2) a population group; or (3) a public or nonprofit private medical facility." 42 C.F.R. § 5.2 (1985)

See Schuster, 800 F.2d at 674. Before Sister Francine interviewed for the position, she obtained permission to do so. Schuster, 84 T.C. at 768.

The Clinic had a family health service program. Id. Although not affiliated with the Order, the Clinic was a Catholic charity. Id. at 786 n.2 (Korner, J., dissenting).

Schuster, 800 F.2d at 674. Part of the Clinic's staff was employed through the NHSC. Schuster, 84 T.C. at 768. The NHSC paid the employees and they received federal employee benefits. Schuster, 800 F.2d at 675. In effect, Sister Francine was treated as a civil servant. Id.

See Schuster, 800 F.2d at 675. The letter to the Clinic read in pertinent part:

The Community of Adorers of the Blood of Christ would like to contract with you for the services of Sister Francine Schuster, ASC, for the position of nurse-midwife for one year at Su Clinica Familiar.

If our offer is acceptable, we request that payment for her services be made to the Adorers of the Blood of Christ.

Brief for Appellant at 11, Schuster v. Commissioner, 800 F.2d 672 (7th Cir. 1986) (No. 85-2345).

See Schuster, 800 F.2d at 675. The Clinic formally accepted Sister Francine onto their staff. Id. The Clinic's administrator further offered a suggestion as to how to endorse the checks over to the Order. Id.

See id.

Sister Francine worked from July 23, 1979 until 1982, when federal funding stopped. Id.

See id.

See id. Sister Francine claimed her income was not subject to taxation by reason of her being an agent of a religious order pursuant to Rev. Rul. 77-290. Schuster, 84 T.C. at 771. See Rev. Rul. 77-290, 1977-2 C.B. 26 (income received by member as agent is income of Order and not member). See also Wittenbach, supra note 4, at 555 (if religious member performs services for charitable organization, agency relationship must be established for tax exemption).
that Sister Francine was not an agent of the Order when she earned the wages.22 Sister Francine filed a petition in the United States Tax Court refuting the determination by the Commissioner.23 The tax court held that petitioner's wages were earned in her individual capacity, not as an agent of the Order and were therefore subject to federal taxation.24 The Court of Appeals for the Seventh Circuit affirmed the tax court's decision.25

Writing for the majority, Judge Barker26 held that the decision of the tax court, albeit by a different analysis, was effectually correct.27 The Seventh Circuit rejected the "agency triangle" test espoused by the tax court deeming it too narrow an approach in ascertaining Sister Francine's tax liabilities.28 After acknowledging the applicable tax provision,29 Judge Barker proceeded to adopt a flexible test30 which was to be based on a

22 Schuster, 800 F.2d at 675.
23 Id. at 675-76.
24 See Schuster, 84 T.C. at 778. The tax court, in holding that Sister Francine's income was taxable, relied on a "triangle agency" theory. See id. at 775-76. The majority, in an opinion written by Judge Wilbur, concluded that the Order, the Clinic, and the NHSC were not contracting for Sister Francine's services. See id. at 775-76. Sister Francine was thereby deemed a federal employee because she had contracted individually to perform services for the Clinic. See id. She had, in effect, received wages and assigned them over to the Order. See id. at 773-74. Applying fundamental tax law and casting aside any reference to Sister Francine's contractual relations with the Order, the court rendered her income taxable. See id. at 773.
25 See Schuster, 800 F.2d at 679.
26 See id. at 673. Judge Barker of the United States District Court for the Southern District of Indiana, sitting by designation. Id.
27 See id. at 679.
28 See id. at 677. The court expressly rejected this argument. Id. The "agency triangle" test is premised on a finding that the employer and the principal expressly contracted for the agent's services and the income earned is for the principal's benefit. Id. See Schuster, 84 T.C. at 775-76 (indication of control and relationship between parties is necessary for income to be imputed to principal on "agency triangle" theory). See also Johnson v. United States, 698 F.2d 372, 374 (9th Cir. 1982) (income earned by an agent not imputed to principal because control of agent's activities and recognition by third party lacking). However, the Schuster court felt that the Johnson two part test was too constrained as well as an inadequate inquiry. Instead, the court opted to analyze other relevant factors in conjunction with the third party employer and principal relationship. Schuster, 800 F.2d at 678.
29 See Schuster, 800 F.2d at 676; I.R.C. § 61(a)(1) (1986). This section states: "Except as otherwise provided in this subtitle, gross income means all income from whatever source derived, including . . . (1) [c]ompensation for services, including fees, commissions, fringe benefits and similar items." Id. See also Commissioner v. Glenshaw Glass Co., 348 U.S. 426, 430 (1955) (gross income includes "all gains except those specifically exempted").
30 The flexible test was previously utilized in the Fogarty case. See Fogarty v. United States, 780 F.2d 1005, 1012 (Fed. Cir. 1986). The factors analyzed by the test include:

[(1)] the degree of control exercised by the Order over the member. . . [(2)] ownership rights between the member and the order. . . [(3)] the purposes or mission of the order. . . [(4)] the type of work performed by the member vis-a-vis those purposes or
factual analysis of each case.  
Judge Cudahy, writing as the lone dissenter, observed that the majority was unduly prejudiced in its analysis due to its staunch adherence to a fundamental tax theory and the alarming growth of the tax protest movement. Although agreeing that the "agency triangle" test was appropriately rejected, the dissent also found the majority's flexible test inapplicable. Instead, Judge Cudahy proposed a three part test which would effectively determine whether Sister Francine was acting as an agent of the Order. Judge Cudahy concluded that proper application of

mission. . . [(5)] the dealings between the member and the third-party employer, ([including the] circumstances surrounding job inquiries and interviews, and [the] control or supervision exercised by the employer), and [(6) the] dealings between the employer and the order.

Id. at 1012.

See Schuster, 800 F.2d at 677. The court, in reaching this conclusion, relied heavily on the Fogarty case. See id. Fogarty involved a priest who taught in a university and who, pursuant to a vow of poverty, signed his checks directly over to his Order. Fogarty, 780 F.2d at 1006. The Fogarty court, in determining that Father Fogarty earned his income as an individual rather than as an agent of his Order, rejected the "agency triangle" and "loaned out employee" theories and instead relied upon six relevant factors in addition to general rules of agency. See id. at 1012.

The Schuster court noted that this flexible approach was more appropriate in the case before it and thereby inquired into the underlying facts. Schuster, 800 F.2d at 677.

See Schuster, 800 F.2d at 679 (Cudahy, J., dissenting). Judge Cudahy focused on the court's underlying rationale, which he believed stemmed from Justice Holmes' opinion in Lucas v. Earl, 281 U.S. 111 (1930). See Schuster, 800 F.2d at 679 (Cudahy, J., dissenting). This principle was premised on the notion that the mere assignment of income by the earner would not shift the tax burden along with it. Lucas, 281 U.S. at 115.

See Schuster, 800 F.2d at 680 (Cudahy, J., dissenting). Judge Cudahy also claimed that this decision was a reaction to the tax protest movement, where some people had fraudulently used the religious exemption in an attempt to avoid taxation. See id. (Cudahy, J., dissenting). Unfortunately, changing policies in this area worked only to impose a hardship on a legitimate claim. See id. (Cudahy, J., dissenting).

See id. (Cudahy, J., dissenting). Judge Cudahy declared that the test proposed by the majority was strangely similar to the Johnson court test which was supposedly cast aside for being too narrow and inflexible. See id. (Cudahy, J., dissenting).

See id. at 682 (Cudahy, J., dissenting). Judge Cudahy emphasized three factors. The first and most controlling factor focused on whether the principal had a "right to direct or control the agent's activities in a meaningful way." See id. (Cudahy, J., dissenting). Secondly, the question was whether the principal had "the right to claim and take possession of the compensation" without any adverse claim. See id. (Cudahy, J., dissenting). Finally, whether the services performed were of the type "within the mission or purpose of the alleged principal." See id. at 683 (Cudahy, J., dissenting).

See id. at 682-83 (Cudahy, J., dissenting). The dissent analyzed the relevant facts in the case, including the binding vow of poverty, the purposes of the Order, and the close fundamental control the Order exerted over Sister Francine. See id. (Cudahy, J., dissenting). Judge Cudahy shifted the focus away from the formal dealings of the parties and concluded that a proper analysis would render Sister Francine an agent of the Order. See id. at 683-84 (Cudahy, J., dissenting).
the law to economic realities would necessitate a determination that Sister Francine's income was not taxable.\textsuperscript{37} The \textit{Schuster} court recognized that income earned by a member of a religious order is not automatically exempted from taxation unless an agency relationship can be established.\textsuperscript{38} It is submitted that the court adopted an overly technical approach that lent itself to a superficial analysis. This Comment will analyze the flexible factors relied upon by the court and suggest that relevant tax law and agency theory tend to establish a gray area where tax exemption is applicable despite the growing tax protest movement. Finally, it will address the possible tax implications of the \textit{Schuster} decision on those seeking outside employment in furtherance of their religious vows.

**TAXATION AND THE AGENCY RELATIONSHIP**

The Congressional power to tax income was greatly expanded by the passage of the sixteenth amendment.\textsuperscript{39} Inherent in this provision is the power to exempt certain charitable or religious organizations.\textsuperscript{40} Unless exempted, all income received or assigned is taxable to the earner, regardless of whom actually receives the money.\textsuperscript{41} However, if the income earner does not have control over the money, there would be no personal tax

\textsuperscript{37} See \textit{id.} at 684 (Cudahy, J., dissenting).

\textsuperscript{38} \textit{Id.} at 679. See \textit{Fogarty v. United States}, 780 F.2d 1005, 1005 (Fed. Cir. 1986). The court held that the evidence was sufficient to find that a priest was not acting as an agent of his Order and, therefore, his income was taxable to him individually. \textit{Id.} at 1006. See also \textit{Kelley v. Commissioner}, 62 T.C. 131, 138 (1974) (priest working outside his agency taxed on income earned).

\textsuperscript{39} U.S. Const. amend. XVI. See \textit{supra} note 1 and accompanying text.

Before the sixteenth amendment was enacted, Congress relied on article I of the Constitution to raise revenue. \textit{Hageman}, \textit{supra} note 4, at 406. Although the power to tax had always been present, the apportionment provision restricted congressional latitude. \textit{Id.} It was not until the enactment of the sixteenth amendment that the government could control who bore the tax burden without concern for apportionment. \textit{Id.}

\textsuperscript{40} See \textit{Brushaber v. Union Pac. R.R.}, 240 U.S. 1 (1916). The Court emphasized that exemptions for certain entities were constitutionally sound based on the sixteenth amendment. \textit{See id.} at 21. See also \textit{Hageman}, \textit{supra} note 4, at 406. (sixteenth amendment impliedly gave Congress power to tax and exempt religious organizations).

\textsuperscript{41} \textit{Lucas v. Earl}, 281 U.S. 111 (1930). In this landmark tax case, Justice Holmes, writing for the majority, held that taxation could not be circumvented by contracts or agreements which would prevent salaries from vesting in the income earner. \textit{Id.} at 115. This fundamental tax theory has been followed in many of the Court's later decisions. \textit{See, e.g.}, \textit{United States v. Basye}, 410 U.S. 441, 450 (1973) (application of \textit{Lucas} principle to partnership); \textit{United States v. Joliet & Chicago R.R.}, 315 U.S. 44, 48 (1942) (payments made to shareholders by lessee of corporate property are corporate income). \textit{See also} \textit{Commissioner v. Culbertson}, 337 U.S. 733, 739-40 (1949) (Court described first rule of taxation as "income must be taxed to him who earns it").
Traditionally, agents of tax exempt organizations were not personally taxed because the right of control over the income earned vested in the organization. An agency relationship exists when the manifestations of the parties demonstrate that the agent consented to act on behalf of and under the control of the principal. An express contract is not necessary, but mutual consent is required. In Schuster, Sister Francine's vows created a binding contract with the Order. The Order's acceptance of these vows

43 See Poe v. Seaborn, 282 U.S. 101 (1930). The Court held that a husband and wife in a community state had the right to file separate returns using one half of the community income as their respective incomes. Id. at 118. Each party, in effect, controlled one half of the income. The husband could escape taxation on one half of the income because under community property laws, he was an agent of the community and had no claim or control over the total amount. Id. at 112.

It is submitted that the dissent in Schuster properly reasoned that Poe represented an analogous situation to the one presented to the court and correctly argued that the income earned by Sister Francine was never hers alone, but belonged to the Order. See Schuster, 800 F.2d at 683 (Cudahy, J., dissenting). But see Fogarty v. United States, 780 F.2d 1005, 1009 (Fed. Cir. 1986) (rejecting analogy between marital and order/member relationships).

44 Maryland Casualty Co. v. United States, 251 U.S. 342 (1920). The Court held that the income received by the agent for the principal should be taxed to the principal. Id. at 345. See supra note 42 and accompanying text. Cf. McGahen v. Commissioner, 76 T.C. 468, 480 (1981) (alleged clergy taxed on income because he did not act as agent nor modify his financial behavior after taking poverty vow).

45 See Restatement (Second) of Agency § 1 (1958); see also Columbia Univ. Club v. Higgin, 23 F. Supp. 572, 574 (S.D.N.Y. 1938) (agent was representative and acted for another within his authority; therefore principal-agent relationship existed).

46 See Restatement (Second) of Agency § 1 comment b (1958). Inherent in the definition of agency is the existence of a consensual relation. Id. Consequently, many courts have held that an agency relationship is created by express or implied contract or by operation of law. See, e.g., Rufenacht v. Iowa Beef Processors, 492 F. Supp. 877, 881 (N.D. Tex. 1980) (although not found to exist in present case, agency denotes relationship created by express or implied agreement), aff'd, 656 F.2d 198 (5th Cir. 1981), cert. denied, 455 U.S. 921 (1982); Slates v. International House of Pancakes, 90 Ill. App. 3d 716, 724, 413 N.E.2d 457, 463 (1980) (consensual fiduciary relationship created by law by which principal may control agent and agent affects legal relationships of principal).

47 See Schuster, 800 F.2d at 683 (Cudahy, J., dissenting); see also Order of St. Benedict v. Steinhauser, 234 U.S. 640, 651 (1914) (prerequisite of relinquishment of all private property rights upon entering into ecclesiastical society held to be binding agreement on both parties but not violative of public policy).

It is also noteworthy that the majority did not address the solidity of the agreement between Sister Francine and the Order. The court instead focused on the fact that the Sister could have left at anytime. See Schuster, 800 F.2d at 678. However, it is submitted that the court missed the real issue—the nature of the agency relationship at the time the income was earned. Gratuitous agents, acting without any remuneration and free to leave at will, can still affect the legal relationships of both third parties and the principal while acting as an agent. See Restatement (Second) of Agency § 16 comment b (1958); see also Trinity Lutheran Church, Inc. v. Miller, 451 N.E.2d 1099, 1102 (Ind. App. 1983) (church held liable for tort committed by gratuitous agent). Sister Francine's freedom to possibly
manifested the mutual consent necessary in creating an agency relationship.  

The principal-agent agreement also creates a fiduciary relationship in which the agent owes a duty of loyalty to the principal. Consequently, although Sister Francine was an employee of the Clinic and the government, she was still bound to act primarily on behalf of the Order in any situations that arose. Also, pursuant to agency law, the agent must obey all reasonable directions of the principal. Sister Francine, by agreeing to effectuate the objectives of the Order, was required to comply with any directives sent by the Order, whether they were employment related or personal in nature. Moreover, a principal has the right to control the agent in relation to the matters in issue. The Order, in addition to controlling Sister Francine’s acceptance of the job offer and the money she received on behalf of the Order, could, at any time, demand she terminate her association with the Clinic. It is submitted that agency law dictates withdraw from the Order would not affect the binding agreement with the Order and therefore was an irrelevant inquiry. See Schuster, 800 F.2d at 680 (Cudahy, J., dissenting).

To be accepted into the Order, a member had to agree to subordinate her will in furtherance of the Order’s mission. Schuster, 84 T.C. at 766. The Order thereby assumed control over its members’ missions and remunerations. See supra note 11 and accompanying text. This fiduciary relationship exists because the agent has the power to effectuate the legal relationships of the principal. Id. § 13 comments a, b. See also Cozzens v. Bazzani Bldg. Co., 456 F. Supp. 192, 198 (E.D. Mich. 1978) (fiduciary obligation demands “not honesty alone, but the punctilio of an honor the most sensitive” (quoting Meinhard v. Salmon, 249 N.Y. 458, 463, 164 N.E. 545, 546 (1928))).

See Restatement (Second) of Agency § 387 (1958). See also Campagna v. United States, 474 F. Supp. 573, 585 (D.N.J. 1979) (agent held to high standard of honesty and is under duty to be careful, skillful, diligent, and loyal in performance).

Schuster, 800 F.2d at 682 (Cudahy, J., dissenting). This is a corollary of the principal’s right to control emanating from the basic agency definition. Cf. Kelley v. Commissioner, 62 T.C. 131, 138 (1974) (no longer agent, since his “vow of obedience” lacked substance).

Schuster, 800 F.2d at 682 (Cudahy, J., dissenting). Adhering to a directive from her Order, Sister Francine notified the Clinic that she could not dispense artificial contraceptives. Id. (Cudahy, J., dissenting) The dissent noted that the Order’s directive altered her work routine so as to conform with the moral precepts observed by the Order. Id. (Cudahy, J., dissenting).

See Restatement (Second) of Agency § 14 (1958); see also British Am. & E. Co. v. Wirth Ltd., 592 F.2d 75, 80 (2d Cir. 1979) (agent under control and supervision of principal binds principal when acting within ambit of authority); Kirchen v. Orth, 390 F. Supp. 313, 317 (E.D. Wis. 1975) (extent and right of control are valid issues when determining whether agency exists).

See Schuster, 800 F.2d at 680-81 (Cudahy, J., dissenting). Despite the fact that Sister Francine could resign at any time, the ubiquity of the Order’s control overwhelmed the member. See id. (Cudahy, J., dissenting). Cf. McGahen v. Commissioner, 76 T.C. 468, 479 (1981) (income accepted without Order’s intervention nor accounting; Order’s minimal degree of control indicated that he contracted and functioned as individual); Macior v. Commissioner, 48 T.C.M. (CCH) 91, 93 (1984) (contracting with University as individual, never
a finding that Sister Francine and the Order were acting in a principal-agent capacity created by Sister Francine's vows.

**THE FLEXIBLE FACTORS APPLIED**

The court in *Schuster* looked beyond the basic agency theory and utilized a flexible test to hold that an agency relationship did not exist when Sister Francine worked for the Clinic.55 In applying its test, the court concluded that direct control was not manifested by the Order.56 However, all of Sister Francine’s acts while employed at the Clinic were subject to the Order’s approval thereby demonstrating its fundamental control over virtually every aspect of her life.57 The fact that the paychecks were payable to Sister Francine led the majority to conclude that she possessed dominion and control over them.58 In reality, Sister Francine obediently endorsed each check over to the Order.59 Due to the binding contractual obligation created by her vows, Sister Francine did not have an exclusive right to the checks.60

In addressing the factors which dealt with the type of employment and its relationship to the purposes of the Order, the court conceded that these factors supported the existence of an agency relationship because Sister Francine’s duties were consistent with the enumerated purposes of remitting salary to Order, and ex post facto attempts to negate personal ownership indicated he was not controlled by Order and his income was taxable).  

68 Schuster, 800 F.2d at 678-79. See Fogarty v. United States, 780 U.S. 1005 (Fed. Cir. 1986). The Fogarty court decided that in order to establish an agency relationship between a priest and an Order the underlying facts should be considered. Id. at 1012. It is submitted that the Schuster court misinterpreted the Fogarty decision and applied the factors too rigidly and without an adequate understanding of the unique facts in each case.  

69 Schuster, 800 F.2d at 678. The court based this determination on two basic indicia. Id. First, Sister Francine could withdraw from the Order at any time; secondly, the Order did not exert day-to-day control over her. Id.  

70 See id. at 681-82 (Cudahy, J., dissenting). The Order visited Sister Francine and if it were found that she did not comply with its directives, she would be told to leave the employment. See id. at 682 (Cudahy, J., dissenting).  

71 Id. at 678.  

72 See id.  

73 Id. at 681 (Cudahy, J., dissenting). As the dissent noted, the court absolutely glazed over the fact that Sister Francine’s vows were not only legally binding, but also morally binding. Id. (Cudahy, J., dissenting). See L. FANFANI & K. O’ROURKE, CANON LAW FOR RELIGIOUS WOMEN 199 (1961) (promise to obey is promise to God). See also Order of St. Benedict v. Steinhauser, 234 U.S. 640, 651 (1914) (recognizing binding status of vow of poverty). Furthermore, it is submitted that economic reality had been overlooked. Sister Francine received no money, except for her thirty-five dollar monthly allowance, yet was taxed on the full amount of earnings. Cf. Kelley v. Commissioner, 62 T.C. 131, 135 (1974) (priest controlled his own money, opened up savings account, purchased car and retained all earnings upon leaving Order).
Finally, the remaining factors considered by the court involved the interrelationship of the NHSC and the Clinic, Sister Francine and the Order. As indicia of Sister Francine's individual capacity, the court noted that she found the job on her own, never mentioned her agency relationship with the Order, and the Order's request to be paid directly went unanswered by the NHSC. However, this finding is erroneous in light of the degree of control exercised by the Order over its members and the presence of a statement on file at the Clinic and the NHSC clarifying Sister Francine's commitment to the Order. The letter from the Clinic further advanced the proposition that the interrelationships existed with the employer's knowledge of all the circumstances surrounding Sister Francine's loyalties and personal convictions.

It is submitted that upon a factual analysis, the factors weigh heavily in favor of the existence of an agency relationship and therefore tax exemption.

**TAX AVOIDANCE**

Situations do arise where wages of religious members are properly taxed. This usually occurs when the member, under the guise of religious agency, deviates from the vow of poverty, or obtains employment

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61 Schuster, 800 F.2d at 678. See also Rev. Rul. 68-123, 1968-1 C.B. 35 (nun working as nurse, furthering purposes of Order, deemed an agent of the Order and not taxed individually).

62 Schuster, 800 F.2d at 678. Specifically, these factors involved the nature and extent of the dealings between all the parties. Id.

63 Id. Cf. Fogarty v. United States, 780 F.2d 1005, 1007 (Fed. Cir. 1986) There was no agreement between the University and Father Fogarty's Order. Id.

64 See Schuster, 800 F.2d at 682 (Cudahy, J., dissenting). The dissent introduced a document on file at the NHSC which certified that Sister Francine was a member of the Order and under a vow of poverty. Id. (Cudahy, J., dissenting). It further stated that she performed her services on behalf of the Order as an agent and all salaries would accrue to the Order. Id. (Cudahy, J., dissenting).

65 See id. at 675. Cf. Johnson v. United States, 698 F.2d 372, 374 (9th Cir. 1982). Johnson is clearly distinguishable from Schuster because the third party in that case knew of the agency relationship and adamantly refused to deal with the principal. See id. It is submitted that since the Clinic and the NHSC knew of and did not strongly dispute the agency relationship, an inference can be drawn that they acquiesced to it.

66 O.D. 119, 1 C.B. 82 (1919). This official decision reads in pertinent part: "Members of religious orders are subject to tax upon taxable income, if any, received by them individually ...." See Fogarty, 780 F.2d at 1010. The court found that members of religious orders are not always regarded as agents of their orders for federal tax purposes. Id. See also Myers, supra note 4, at 223 (based on revenue rulings certain religious members would be taxed); Hageman, supra note 4, at 425 (members' incomes under poverty vow may or may not be taxed depending on its source).

67 See, e.g., Kelley v. Commissioner, 62 T.C. 131, 135 (1974) (although still member of Order and presumably under vows of poverty and obedience, member had bank account and car and even married before granted dispensation to marry); Macior v. Commissioner, 48
in a secular area unrelated to the purposes of the order. Furthermore, a rash of tax protest cases have inundated the courts in recent years, yielding various examples of appropriate taxation measures taken against alleged religious members. However, sincere members of genuine religious orders are being forced to suffer the consequences of the general movement towards taxation.

It is submitted that by taxing Sister Francine, the court did not inquire into her true devotion, but instead painted a policy statement using a broad brush and overly subjective criteria.

**Implications of the Schuster Decision**

A pertinent question must be answered in the aftermath of the Schuster decision. This question is what, if any, is a favorable tax alternative? If the courts refuse to recognize the agency relationship in such situations there is another, although less desirable, tax alternative. The religious member could claim a charitable deduction based on the amount of income submitted to the Order. However, the applicable Internal Revenue Code section reveals that such income would not be exempt from tax since the individual charitable contribution provision provides

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T.C.M. (CCH) 91, 93 (1984) (where Franciscan Friar held bank accounts as individual, had unlimited access to income and never remitted income to Order, he had deviated from vow of poverty and his income was taxable).

*See Rev. Rul. 77-290, 1977-2 C.B. 26. A religious member working as an associate in a law firm, although doing so as directed by his superiors, was not engaged in employment in furtherance of the purposes of his religious order. Id. His income was fully taxed to him because of the secular nature of the employment. Id.*

*See, e.g., United States v. Ebner, 782 F.2d 1120, 1126 (2d Cir. 1986) (defendants took fraudulent vows of poverty knowing they did not meet requirements for tax exemption); Mone v. Commissioner, 774 F.2d 570, 574 (2d Cir. 1985) (taxpayers fined for negligent and intentional disregard of tax rules); Sprow v. Commissioner, 748 F.2d 914, 915 (4th Cir. 1984) (taxpayer's claim of exemption is frivolous without proof of religious Order); Stephen v. Commissioner, 748 F.2d 331, 333 (6th Cir. 1984) (unchanged lifestyle, irregular services, and other factors indicated that church was pretense for tax avoidance purposes). Id.*

*Schuster, 800 F.2d at 680 (Cudahy, J., dissenting). See, e.g., Young v. Commissioner, 49 T.C.M. (CCH) 1474, 1477 (1985) (nun taxed on income earned as physical therapist); Woltering v. Commissioner, 49 T.C.M. (CCH) 1480, 1483 (1985) (nun taxed on income received for mental counseling services). See also B. Hopkins, The Law of Tax Exempt Organizations 175 (4th ed. 1983) (law is becoming tough regarding sham situations, but resulting legal principles are highly questionable outside areas of abuse).*

*I.R.C. § 170(c)(2)(B) (1986). This section allows a deduction for income given as a gift to “a corporation, trust, or community chest, fund or foundation-organized and operated exclusively for religious, charitable, scientific, literary or educational purposes . . . .” Id. See Rev. Rul. 76-323, 1976-2 C.B. 18. This Revenue Ruling suggested that if the income is not exempt, a member would include in gross income the entire remuneration received, whether or not retained for living expenses. Id. However, each member would be entitled to a charitable contribution deduction for a portion of the amount given to the Order. Id. See also Hageman, supra note 4, at 425 (member may deduct part of remuneration under section 170).*
for only a partial deduction.\textsuperscript{78}

Based on the Schuster court's elevation of the "form" of the employment over the "substance" of the relationship, an unfavorable tax result could be avoided by taking precautions at the initial stages of the relationship. The Schuster court focused on superficial control.\textsuperscript{79} Unfortunately, the court failed to recognize the amount of control which an order actually exerts over its members.\textsuperscript{74} Whenever possible, it would be wise to specify the extent of the order's control over its agent's employment and require the potential employers to accept these terms.\textsuperscript{75} In lieu of approving the member's employment contract, the order should independently contract with the employer and require payments be made directly to the order. Naturally, it would be within the order's discretion to accept only those employment relationships that clearly advance the order's purposes if they are interested in avoiding taxation problems. Judicial review of like situations should also focus on the case before it, taking into account the realities of control, the actual right to the income, and whether the purposes of the order are being advanced by the employment.\textsuperscript{76} It is submitted that this approach would be more equitable than relying on a functionally inflexible test. A careful factual analysis applying appropriate agency and tax concepts would avoid future distortions. It is submitted that although an order has an affirmative duty to clarify its relationship with a member, the courts also have a duty to set aside a "tax all" attitude and distinguish tax avoidance schemes from true tax exempt situations.

\textsuperscript{78} I.R.C. § 170(b)(1)(A) (1986). This section states that any charitable deduction to a qualified organization "shall be allowed to the extent that the aggregate of such contributions does not exceed fifty percent of the taxpayer's contribution base for the taxable year." \textit{Id. See supra} note 71 and accompanying text. \textit{See also} Wittenbach, \textit{supra} note 4, at 556 (discussing section 170(b)(1) as alternate tax consequence).

\textsuperscript{79} \textit{See Schuster}, 800 F.2d at 678. The majority claimed that Sister Francine could leave at any time and the Order did not retain day-to-day control over her. \textit{Id. It is submitted that the control exerted by the Order was more than the court perceived.}

\textsuperscript{74} \textit{See L. Fanfani} & K. O'Rourke, \textit{supra} note 60, at 199. The vow of obedience is a promise made essentially to God. \textit{Id. The vow of obedience demands surrender of one's will by subjecting oneself to the will of lawful superiors. Id. Furthermore, when a superior commands something that is within the rule, it is binding under pain of sin. Id. at 202.}

\textsuperscript{75} \textit{See Rev. Rul. 68-123, 1968-1 C.B. 35. The nun was deemed to be under the Order's control because the Order affirmatively arranged for the nun's assignment to the hospital. Id. It is submitted that although it may be more burdensome, perhaps the Order should make more of an effort to supervise the nun's activities.}

\textsuperscript{76} \textit{See Schuster}, 800 F.2d at 682 (Cudahy, J., dissenting). The factors suggested by the dissent, focusing on control, possession, and advancement, emphasize that formalities are not persuasive and that factual situations and economic realities should control. \textit{Id. at 683-84} (Cudahy, J., dissenting).
CONCLUSION

The court in Schuster disallowed a tax exemption for a nun who worked outside her Order, albeit in furtherance of the Order's religious and charitable purposes. The tax court and the Seventh Circuit held that Sister Francine had not successfully proven that her duties had been performed as an agent of the Order. It is submitted that the court erred in its application of appropriate agency law, thus failing to properly determine Sister Francine's legal relationship with her Order. It is further suggested that the analysis employed by this court digressed from the core elements and instead focused on a rigid and inappropriate test. The decision of the Schuster court should signal to similarly situated religious members an awareness of the possible tax consequences resulting from their vocation.