Charitable Tax Exemptions As State Action (Jackson v. Statler Foundation)

Kate Monica Walsh

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CONSTITUTIONAL LAW

CHARITABLE TAX EXEMPTIONS AS STATE ACTION

Jackson v. Statler Foundation

A party seeking vindication of his civil rights may maintain a civil action for damages pursuant to 42 U.S.C. § 1983.¹ In asserting a section 1983 claim, however, the plaintiff must show that his constitutional rights have been abridged by a person acting "under color of" state law or custom; in effect, he must satisfy the state action requirement of the fourteenth amendment.²

The doctrine of "state action" as a prerequisite to the application of federal civil rights laws originated with the Civil Rights Cases.³ There, the Supreme Court instructed that invasion of a person's rights by an individual is merely a "private wrong," not within the purview of the fourteenth amendment.⁴ However, as the state action doctrine has evolved in our jurisprudence, particularly in the field of racial discrimination,⁵ its parameters have been broadened to include much activity at least "private" in appearance. Thus, for example, a finding

¹ 42 U.S.C. § 1983 (1970) provides:
Every person who, under color of any statute, ordinance, regulation, custom, or usage, of any State or Territory, subjects, or causes to be subjected, any citizen of the United States or other person within the jurisdiction thereof to the deprivation of any rights, privileges, or immunities secured by the Constitution and laws, shall be liable to the party injured in an action at law, suit in equity, or other proper proceeding for redress.
The Supreme Court, in United States v. Classic, 313 U.S. 299 (1941), set down the following often cited definition which has been utilized in connection with the state action doctrine:
Misuse of power, possessed by virtue of state law and made possible only because the wrongdoer is clothed with the authority of state law, is action taken "under color of" state law.

² "In cases under § 1983, ‘under color’ of law has consistently been treated as the same thing as the ‘state action’ required under the Fourteenth Amendment.” United States v. Price, 383 U.S. 787, 794 n.7 (1966). See also Adickes v. S.H. Kress & Co., 398 U.S. 144, 163 (1970), wherein the Court stated:
[T]he legislative history of § 1 of the 1871 Act, [the Ku Klux Klan Act] the lineal ancestor of § 1983 . . . indicates that the provision in question here was intended to encompass only conduct supported by state action.
³ 109 U.S. 3 (1883). In these five cases, the first and second sections of the Civil Rights Act of 1875 were declared unconstitutional because they afforded a cause of action against private individuals under the fourteenth amendment.
⁴ Id. at 17.
of state action may be appropriate when the "private" offender is engaged in a joint activity with the state. State action has also been found where the state was perceived as compelling, authorizing, or encouraging private discrimination, either directly or indirectly. Further discussion of joint action was fully explored in Burton v. Wilmington Parking Auth., 365 U.S. 715 (1961), wherein the Court found a sufficient nexus between the racially discriminatory activity and the state government. In Burton, the appellant was denied service, solely on the basis of race, in the Eagle Coffee Shoppe, Inc., a private restaurant located on premises leased from the Parking Authority, an agency of the state. The Court was of the opinion that "[o]nly by sifting facts and weighing circumstances can the non-obvious involvement of the State in private conduct be attributed its true significance." Id. at 722. The Court accordingly recognized that the restaurant was in a publicly owned building devoted to "public uses," that public funds were spent for necessary repairs, that many mutual benefits were enjoyed by the Parking Authority and restaurant, and that any improvements in the leasehold made by the lessee would be tax exempt as the fee was held by a government agency. The Court concluded: "The State has so far insinuated itself into a position of interdependence with Eagle that it must be recognized as a joint participant in the challenged activity ...." Id. at 725.

Burton thus established the "symbiotic relationship" test for use in the search for state action. However, the majority was careful to restrict its holding to the particular facts at bar: "[T]he conclusions drawn from the facts and circumstances of this record are by no means declared as universal truths on the basis of which every state leasing agreement is to be tested." Id. This cautious approach had been criticized as affording no guidelines for settling similar disputes.

In Burton the Court selected a highly particularistic approach. This increases the burden of explanation, because easy generalities will not suffice—difficulties will be presented in later cases in which the state action problem is conceptually the same but the underlying social problem is different. Instead of meeting this burden, the Court, by emphasizing all the facts, appears to have done its best to decide a case without creating a precedent.

Lewis, Burton v. Wilmington Parking Authority—A Case Without Precedent, 61 Colum. L. Rev. 1458, 1466 (1961). It is submitted that such a factual emphasis is indicative of the Court's reluctance to further expand the state action doctrine.

The compulsion cases have generally dealt with specific state statutes fostering racial discrimination. See, e.g., Peterson v. City of Greenville, 375 U.S. 244 (1963) (city ordinance required segregation by race in restaurants); Turner v. Memphis, 389 U.S. 350 (1962) (per curiam) (state statute provided for segregation in restaurants). Cf. Robinson v. Florida, 378 U.S. 153 (1964) (nonsegregated restaurants burdened under State Board of Health regulations). In Turner, the pertinent state statute was not challenged, and so, the case was decided on the authority of Burton. 369 U.S. at 353.

However, in Adickes v. S.H. Kress & Co., 398 U.S. 144 (1970), the Court held that a state statute is not necessary for a finding of state "compulsion" under the fourteenth amendment, since "a state official might act to give a custom the force of law in a variety of ways ...." Id. at 172. Moreover, Shelley v. Kraemer, 334 U.S. 1 (1948), stands for the proposition that judicial enforcement of a private, racially discriminatory covenant is sufficient compulsion by the state to be violative of the fourteenth amendment.

In Terry v. Adams, 345 U.S. 461 (1953), blacks deprived of the right to vote in primaries conducted by the Jaybird Party solely on the ground of race claimed violation of their fifteenth amendment rights. The Court saw this conduct by the political party as a means by which the state circumvented the prohibitions of the fifteenth amendment. Id. at 469. Additionally, in Reitman v. Mulkey, 387 U.S. 369 (1967), a California constitutional provision repealed statutes banning racial discrimination in the selling or leasing of residential property and granted complete discretion to the individual homeowner. The Court deemed the provision invalid under the fourteenth amendment on the theory that the state is prohibited from "authorizing" or "encouraging" private racial discrimination.

More recent cases, not dealing with the political process or equal access to housing,
thermore, in certain situations, a private individual’s actions can take on the character of a public function so as to transform his acts into state action.\textsuperscript{9} suggest that the Court has been unwilling to use the \textit{Reitman} theory for a broad expansion of the state action concept. In \textit{Evans v. Abney}, 396 U.S. 435 (1970), land had been conveyed to the city of Macon, Georgia, under a testamentary trust for use as a park for white persons only. After the Court had earlier ruled in \textit{Evans v. Newton}, 382 U.S. 296 (1965), that due to its public character, the park could not be operated under racial restrictions, it was closed. The Georgia courts ruled thereafter that the trust had failed and the property reverted to the testator's heirs. In affirming, the Court held that the petitioner's fourteenth amendment rights were not violated by the refusal of the Georgia courts to apply the \textit{cy pres} doctrine to save the trust by removing the racial restrictions from the will. 396 U.S. at 446.

In \textit{Adickes v. S.H. Kress & Co.}, 398 U.S. 144 (1970), petitioner, having been refused service at respondent's lunch counter because she was in the company of blacks, was arrested for vagrancy upon leaving the premises. In bringing a § 1983 action, petitioner alleged that she was refused service pursuant to a local custom, and that the refusal of service and her subsequent arrest were the product of a conspiracy between the respondent and the police. The lower courts, on a motion for summary judgment, dismissed the complaint before trial. The Supreme Court reversed and remanded, holding that the respondent had not satisfied the burden of proof required for the grant of summary judgment. In examining the “state custom” requirement under § 1983, the Court indicated that the fourteenth amendment is violated only when the discriminatory act is \textit{compelled} by a state-enforced custom, \textit{id.} at 171, that is, a custom which has "the force of law by virtue of the persistent practices of state officials." \textit{id.} at 167.

In \textit{Palmer v. Thompson}, 403 U.S. 217 (1971), the city of Jackson, Mississippi, upon being ordered to desegregate its public recreational facilities, closed four city-owned pools, and surrendered its lease on a fifth to the YMCA, which continued to operate the pool on a segregated basis. Petitioners' demand that the pools be reopened and desegregated was denied. The Court found no evidence that the state continued to be involved in the funding or operation of the remaining segregated pool. Significantly, the Court implied that the "encouragement" theory of state action set forth in \textit{Reitman} is applicable only when there is some evidence of an actual conspiracy between government officials and private individuals. \textit{id.} at 223-24.

\textsuperscript{9} \textit{Marsh v. Alabama}, 326 U.S. 501 (1946), is often cited for the proposition that acts of a private entity can become municipal in nature, and thus fall within the ambit of the fourteenth amendment. The Court therein, while holding that a state cannot impose criminal sanctions on the distribution of religious literature on the streets of a company-owned town, stated:

The more an owner, for his advantage, opens up his property for use by the public in general, the more do his rights become circumscribed by the statutory and constitutional rights of those who use it. \textit{id.} at 506.

Similar facts confronted the Court in \textit{Amalgamated Food Employees Union v. Logan Valley Plaza, Inc.}, 391 U.S. 308 (1968), wherein the Court, citing \textit{Marsh}, held that privately owned property may, in certain circumstances involving first amendment rights, be treated as though it were public. \textit{id.} at 316-18. The Court found that defendant's shopping center served as the community business block and held that the state could not enforce its trespass laws so as to exclude individuals in violation of their first amendment rights. The Court was careful to point out that its holding would not apply to property not ordinarily open to the general public. \textit{id.} at 320.

Where racial discrimination is alleged under the "public function" theory of state action, the Court has more readily found fourteenth amendment violations. The county defendant in \textit{Griffin v. County School Bd.}, 377 U.S. 218 (1964), when ordered to desegregate, appropriated no funds for public schools and by means of a private foundation operated schools for white children only, providing tuition grants and tax credits. The Court found that the operation of government-supported segregated schools constituted a denial of
Mr. Justice Douglas has urged that state regulation of private enterprise, as evidenced by state licensing and supervision, should be viewed as state action. However, the Supreme Court's decision in *Moose Lodge v. Irvis* can fairly be viewed as a definitive rejection of this theory. The appellee in *Moose Lodge*, having been refused service at appellant's private club because of his race, brought a section 1983 suit claiming that the issuance of a state liquor license, with its attendant supervision, constituted state action. Finding no state action, the Court was unwilling to expand the scope of the equal protection clause, and its decision has been viewed as signalling a halt to the search for state action in the face of "private" racial discrimination.


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the petitioners' right to equal protection under the fourteenth amendment. In *Evans v. Newton*, 382 U.S. 296 (1966), the Court drew analogies to the company town in *Marsh* and the elective process in *Terry*, and resolved:

Conduct that is formally "private" may become so entwined with governmental policies or so impregnated with a governmental character as to become subject to the constitutional limitations placed upon state action.

*Id.* at 299.


12 The Court distinguished *Burton*, concluding that "while Eagle was a public restaurant in a public building, *Moose Lodge* is a private social club in a private building." *Id.* at 175. But see Justice Douglas' dissent wherein he points out that liquor licenses in Pennsylvania are issued pursuant to a strict quota system, and at various times during the week only private clubs are permitted to serve liquor, thus being afforded a state-encouraged monopoly of sorts. *Id.* at 182-83.

One passage in the majority opinion may well signify the approach the Court will adopt in the future when presented with a § 1983 claim:

The Court has never held, of course, that discrimination by an otherwise private entity would be violative of the Equal Protection Clause if the private entity receives any sort of benefit or service at all from the State, or if it is subject to state regulation in any degree whatever.

*Id.* at 173.

13 See, e.g., *The Supreme Court, 1971 Term*, 86 HARV. L. REV. 1, 74-75 (1972), wherein the author states:

The fact that the *Moose Lodge* Court, unlike the Court in earlier cases, did not take advantage of plausible opportunities to identify the challenged conduct as state action may indicate that the expansion of the reach of the equal protection clause, which has taken place over the last decade, has come to a halt.


The opinion in the instant case was first handed down as a one paragraph per curiam opinion on December 4, 1973. Judge Friendly requested a poll of judges in regular service regarding en banc reconsideration. The panel asked that no vote be taken until it produced a revised opinion, which was circulated on April 5, 1974. Only half of the judges voted for reconsideration en banc, so pursuant to the Federal Judicial Code, 28 U.S.C. § 46(c) (1970), the request was denied. The majority of the circuit judges in active service agree to the rehearing. *See Second Circuit Note*, 48 St. John's L. Rev. 372 (1975).
erend Donald L. Jackson, appearing pro se, sued thirteen charitable foundations in the Buffalo, New York, area, alleging racial discrimination. Over a period of three years, the plaintiff had sent form letters to approximately 14,900 foundations requesting that each organization name him a member of its board of directors, that scholarships be given to his children, and that grants be made to his own foundation. When the defendants declined his requests, he brought a section 1983 action seeking declaratory and injunctive relief, damages, and the revocation of their tax exempt status as charitable foundations. The Second Circuit, in remanding the appellant’s complaint to the district court which had dismissed it on the authority of Moose Lodge, held that a finding of state action might be warranted by virtue of the tax exemptions granted appellees as charitable foundations.

In its unanimous decision, the Second Circuit panel noted that courts have more readily found state action when the allegedly offensive conduct of a tax exempt organization was racially discriminatory. For example, in McGlotten v. Connally, tax benefits granted to fraternal orders whose membership policies excluded nonwhites were held to be violative of the fifth amendment. The courts in Pitts v. De-

15 Appellant Jackson additionally challenged an alleged pattern of racially discriminatory conduct by the foundations, and sought an order mandating the surrender of their assets to the United States Treasury. The court summarily held that the lower court properly dismissed this claim since the appellant could not seek such a judicial order. 496 F.2d at 636. See Wolkstein v. Port of New York Authority, 178 F. Supp. 209 (D.N.J. 1959).

The complaint was deficient on its face as to revocation of federal and state tax exemptions due to its failure to join parties indispensable to such a suit. In order to maintain a suit seeking such revocation, the Secretary of the Treasury and the New York Tax Commissioner would have to be joined. The Second Circuit noted that joinder of these parties might have obviated the jurisdictional challenge premised upon no “state action.” 496 F.2d at 626 n.2, citing Green v. Connally, 330 F. Supp. 1150 (D.D.C.), aff’d sub nom., Coit v. Green, 404 U.S. 997 (1971) (mem.).

16 496 F.2d at 629.

17 Judge Smith authored the opinion of the panel, which also included Judges Mansfield and Oakes.


20 In the course of its opinion, the court stated: “Congress does not violate the Constitution by failing to tax private discrimination where there is no other act of Government involvement.” Id. at 458 (emphasis in original). The court went on to distinguish the types of tax exemptions challenged, and concluded that the exemptions granted nonprofit
partment of Revenue and Falkenstein v. Department of Revenue similarly found that the granting of tax exemptions to racially exclusive organizations violated the fourteenth amendment. In Smith v. Ymca, the Court of Appeals for the Fifth Circuit held that defendant's tax exempt status, when weighed with other indicia of state involvement, supported a section 1983 claim alleging racial discrimination. On the other hand, in Powe v. Miles, the suspension of four students for demonstrating in opposition to a direct order from the Dean of Alfred University, a private tax-exempt institution, did not constitute state action sufficient to warrant civil rights relief under section 1983. Additionally, the Tenth Circuit, in Browns v. Mitchell, when presented with a factually similar suit under section 1983, held that even though the private university enjoyed a special tax exemption, this was "far short of the requisite State involvement." 

clubs were provided on a neutral basis, and thus as to these exemptions there was no "state action." Id. at 462.

23 462 F.2d 694 (5th Cir. 1972).
24 407 F.2d 73 (2d Cir. 1969).
25 The students sought injunctive, declaratory, and compensatory relief for alleged restraints on their right of free speech. Id. at 79. Distinguishing Marsh and Terry, the court found that the university did not perform a "public function" so as to render its conduct state action. Id. at 80. Furthermore, although the university received direct financial assistance from the state and federal governments, the court concluded that this aid was minimal, and dismissed the contention that state regulation of the university created a sufficient nexus for purposes of the first and fourteenth amendments. In so doing, the court stated: "The state must be involved not simply with some activity of the institution alleged to have inflicted injury upon a plaintiff but with the activity that caused the injury." Id. at 81. Having found that the limited financial assistance afforded by the state did not constitute state action, the court left undecided the question as to whether this might not be the case if the alleged conduct were racially discriminatory. Id.

Four separate colleges comprise Alfred University, and the court did find that the students suspended from the New York State College of Ceramics presented a different case. Because this state-supported institution was operated under contract with the state, the conduct of the Dean of Students did constitute "state action" for purposes of the § 1983 claim. Id. at 82-83. However, the court went on to find that such conduct was not violative of any constitutional rights of the students. Id. at 84-85.

26 409 F.2d 593 (10th Cir. 1969).
27 In addition to exemptions granted all other religious and charitable corporations, the university involved was exempted from taxes on its income from noneducational income producing property. Id. at 595.

28 Id. at 596. The court also remarked:

[There is no suggestion that the claimed involvement is in any way associated with the challenged activity. . . . The benefits conferred, however characterized, have no bearing on the challenged actions beyond the perpetuation of the institution itself.

Id.

In Bright v. Isenbarger, 314 F. Supp. 1382 (N.D. Ind. 1970), aff'd, 445 F.2d 412 (7th Cir. 1971), two students who had been suspended from a parochial high school for violation of a school disciplinary rule sought to be reinstated by an injunction under § 1983.
Finally, the appellants in *Marker v. Shultz*, 20 unsuccessfully challenged the tax-exempt status of unions involved in political activities, the Court of Appeals for the District of Columbia finding that “[a] tax exemption is consistent with a ‘benevolent neutrality’ and government non-involvement with the exempted organization.” 21

The *Jackson* court therefore concluded that an allegation of racial discrimination warrants a less stringent test for the granting of relief under the state action doctrine, 22 and proceeded to set down such a “test” to be applied in determining whether State action is present. The court specified the following five factors to be weighed, indicating that a finding of state action may still be warranted should one factor be absent:

(1) the degree to which the ‘private’ organization is dependent on governmental aid; (2) the extent and intrusiveness of the governmental regulatory scheme; (3) whether that scheme connotes government approval of the activity or whether the assistance is merely provided to all without such connotation; (4) the extent to which the organization serves a public function or acts as a surrogate for the State; (5) whether the organization has legiti-

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21 Id. at 1006. The court found *Walz v. Tax Comm’n*, 397 U.S. 664 (1970), and *Moose Lodge* persuasive and concluded:
What was involved was the determination by Congress to keep the tax exemption of dues and contributions in a neutral stance, rather than to embroil the tax laws and the agencies administering them into involvement with and surveillance of the political activities of the unions.
485 F.2d at 1007. It is arguable that the tax exemptions granted charitable institutions are aimed at promoting the same kind of neutrality with respect to the dispensation of private charitable grants.

In finding no state action in a suit by a labor union to compel publication of an editorial advertisement, the Seventh Circuit noted:
The use tax exemption . . . does represent a “state involvement” in the limited sense that any tax exemption does, but not to a degree which constitutes state participation in the conduct or action of the enterprise granted the exemption.

*Chicago Joint Bd., Amalgamated Clothing Workers v. Chicago Tribune Co.*, 453 F.2d 470, 477 (7th Cir. 1970) (footnote omitted), *cert. denied*, 402 U.S. 973 (1971). The Seventh Circuit is thus in accord with the Second Circuit’s treatment of state financial aid as enunciated in *Powe*. It is also noteworthy that in *Amalgamated*, the tax exemption was just one factor set forth by plaintiff as a basis for the finding of state action. The defendant additionally received revenue from publishing legal notices, and some of its press facilities were located in public buildings. 453 F.2d at 477.

22 496 F.2d at 628. See *Grafton v. Brooklyn Law School*, 478 F.2d 1137, 1142 (2d Cir. 1973); cases cited in note 18 *supra*. 
mate claims to recognition as a 'private' organization in associational or other constitutional terms.\textsuperscript{32}

Applying the test to the defendant foundations, the court suggested that state action was present under all five criteria. However, since the record before the court was meager, it was left to the district court, on remand, to finally determine whether the test was in fact satisfied.\textsuperscript{33} It appeared to the panel that the first factor was established in that tax exemptions, in general, constitute substantial assistance to charitable foundations.\textsuperscript{34} The court suggested that the second criterion was met since, under the 1969 Tax Reform Act, tax-exempt foundations are subject to an intrusive governmental regulatory scheme.\textsuperscript{35} The court placed particular reliance upon the provision of the Act which mandates the distribution of grants in an "objective and non-discriminatory" manner and subjects offending grants to an "excise tax."\textsuperscript{36} However, the court conceded that these provisions were designed to combat nepotism, not to prevent racial discrimination.\textsuperscript{37}

\textsuperscript{32} 496 F.2d at 629.
\textsuperscript{33} Id. at 634. The record before the court was more detailed as to defendant Buffalo Foundation, and so the court was able to find that as to this institution, "the balance must be struck somewhat differently." \textit{Id.} The bylaws of this foundation provide that four members of its seven-member Governing Committee be appointed by public officials. The court, viewing this procedure as a means of involving the public in the foundation's activities, found that "[t]his participation is neither insignificant nor neutral," \textit{id.} at 635, and concluded that on remand, a finding of state action might be warranted even in the absence of other indicia of state involvement.

There is case law support for the court's finding of state action as to defendant Buffalo Foundation. See \textit{Pennsylvania v. Board of Directors of City Trusts}, 353 U.S. 230 (1957) (per curiam) (administration of a racially discriminatory trust by a city agency was held to be violative of the fourteenth amendment); \textit{Mayers v. Ridley}, 465 F.2d 630 (D.C. Cir. 1972) (en banc) (recordation of a racially restrictive covenant held to be state action in that it implied government approval).


The \textit{Jackson} court held that since § 1983 proscribes only conduct by the state, see, e.g., \textit{District of Columbia v. Carter}, 409 U.S. 418, 424-25 (1973); \textit{Wheeldin v. Wheeler}, 373 U.S. 647, 650 n.2 (1963), only state tax exemptions were to be examined on remand. In analyzing the ramifications of tax exempt status, however, the court looked exclusively to the federal exemptions. Since the two exemptions "are clearly linked in practice . . . and in purpose," 496 F.2d at 635, the findings as to the federal system would be applicable.

The relevant New York State provisions are: \textit{N.Y. TAX LAW} §§ 208-9(a)(4), 615 (McKinney 1966), as amended, (Supp. 1974), regarding income and corporate tax deductions; \textit{id.} § 249-c(3), which provides that bequests are exempt from estate tax if the recipient corporation meets the specifications embodied therein; and \textit{id.} § 1230, which exempts such organizations from local taxation. \textit{N.Y. REAL PROP. TAX LAW} § 421 (McKinney 1972) (non-profit organizations) exempts such charitable organizations from property taxes.

\textsuperscript{36} 496 F.2d at 632; 26 U.S.C. § 4945(g) (1970).
\textsuperscript{37} 496 F.2d at 633. The court further observed that the Tax Reform Act of 1969 was partially aimed at \textit{preventing} some foundations from aiding racial minorities. \textit{id.} at 633 n.15. Evidence of such intent is found in those provisions prohibiting foundations from
The court, moreover, decided that the government’s relationship with the foundations is not a neutral one. Since organizations must apply for tax-exempt status, the panel felt that governmental approval of the application equated with certification that the foundation is working in the public interest. The court further noted that the legislative history behind charitable exemptions and deductions clarified that the loss of government revenue was intended to be offset by the government’s relief from additional financial burdens. Accordingly, the court concluded that there is “something approaching a presumption that foundation activities are public functions.” Finally, it appeared to the court that the foundations could not assert the constitutional right of a wholly private organization to be left alone. The court recognized the right to dispose of one’s property as one sees fit as the only appropriate constitutional right assertable by the defendants. However, this right was held unavailable to the defendants in the present context since it could not be exercised in a racially discriminatory manner where the state was involved.

Judge Friendly authored a vigorous dissenting opinion on behalf of the three judges who favored en banc reconsideration. They viewed the panel’s opinion as “analytically unsound, dangerously open-ended, and at war with controlling precedent both in the Supreme Court and in this circuit.” Moreover, they were concerned that the decision could cause irreparable injury to private philanthropy. The dissenters distinguished the McGlotten, Pitts, and Falkenstein cases, relied on by the panel, as involving defendants who blatantly practiced forbidden racial discrimination by excluding blacks from membership in ostensibly public clubs. Additionally, they emphasized that in those cases the challenged activity was clearly government action and that the plaintiffs therein were suing federal or state officials to force revo-
cation of tax benefits. In *Jackson*, however, the foundations themselves were sued; thus a finding of state action in this instance would, in effect, represent a holding that these private parties are agents of the state. Such a determination was viewed as having a far more serious and widespread effect than a finding that the state had improperly fostered private discrimination.\(^4\)

Judge Friendly was fearful that, due to the broad availability of tax exemptions, the court's holding would have a deleterious effect on the myriad organizations receiving such benefits, contrary to the expressed intent of the Supreme Court. In *Walz v. Tax Commission*,\(^4\) the Court, in denying injunctive relief, held that the granting of property tax exemptions by New York to religious organizations was not violative of the first and fourteenth amendments. The Court, in recognizing that tax benefits are to be treated differently than other types of government assistance, stated:

> The grant of a tax exemption is not sponsorship since the government does not transfer part of its revenue to churches but simply abstains from demanding that the church support the state.\(^4\)

Furthermore, the dissent viewed *Powe* and *Moose Lodge* as mitigating against a finding of state action based on the mere fact that the private activity is subject to state regulation. Judge Friendly argued strongly that the lesson to be drawn from those cases is that a finding of state action is appropriate only if the state regulatory scheme fosters or encourages the alleged illegal conduct.\(^4\)

The dissent also found the "public function" theory of state action, as defined by the Supreme Court in *Marsh v. Alabama*\(^5\) and *Amalgamated Food Employees Union v. Logan Valley Plaza, Inc.*,\(^6\) inapposite to the activities of the defendant foundations.\(^5\) In *Marsh*, the Court held that imposing criminal sanctions for the distribution of religious literature on the streets of a company-owned town was violative of the first and fourteenth amendments. Similarly, in *Logan Valley*, the Court found defendant's shopping center served as the community business block and held that the state could not enforce its trespass laws so as to exclude individuals from enjoying their first amendment rights. The

\(^{46}\) 496 F.2d at 637.
\(^{48}\) Id. at 675.
\(^{49}\) 496 F.2d at 638. See *Powe v. Miles*, 407 F.2d 73 (2d Cir. 1968), *discussed in notes* 24-25 and accompanying text *supra*.
\(^{50}\) 329 U.S. 501 (1946), *discussed in note 9 supra*.
\(^{51}\) 391 U.S. 308 (1968), *discussed in note 9 supra*.
\(^{52}\) 496 F.2d at 639.
dissent saw no equivalent "public function" being performed in Jackson.

Judge Friendly contrasted the approach of the Jackson panel with the opinion he had authored almost simultaneously for a unanimous panel in Wahba v. New York University. The appellant therein, a nontenured associate professor at New York University School of Medicine, alleged violation of his first and fifth amendment rights when, owing to a dispute with the defendant, chairman of his department, his contract was not renewed. The project carried out by the parties was financed by a direct federal grant, and the appellant asserted that the relationship thereby created constituted state action. Judge Friendly, finding no state action, examined the government's involvement, distinguished cases involving alleged racial discrimination by federal grantees, and concluded that, in weighing the many variables present, a court must consider "the value of preserving a private sector free from the constitutional requirements applicable to government institutions." Consistent with this view, Judge Friendly, in Jackson, expressed his concern for "preserving an area of untrammeled choice for private philanthropy . . . ."

The dissent pointed out that, as evidenced by the record, several of the defendant foundations had given generously to minority causes, a fact ignored by the majority. However, even if grants had been made on the basis of race, the dissent argued, the absence of sufficient state action dictated that such conduct should not be viewed as constitutionally impermissible. Finally, Judge Friendly concluded that the Jackson decision would pose a serious threat to private charitable institutions, add to the enormous burden on federal courts, and inevitably discourage donors who are unwilling to defend their charitable gifts in court.

Supreme Court treatment of the state action doctrine clearly indicates that, as a general proposition, there is no established formula for finding state action. Ultimately, each case turns on its particular facts, the composition of the Court, and the balance which must

53 492 F.2d 96 (2d Cir. 1974). Judges Moore and Anderson were the other members of the Wahba panel.
54 See Simkins v. Moses H. Cone Memorial Hospital, 323 F.2d 959 (4th Cir. 1963) (en banc), cert. denied, 376 U.S. 938 (1964), discussed in the text accompanying notes 60-62 infra; Kerr v. Enoch Pratt Free Library, 149 F.2d 212 (4th Cir. 1945).
55 492 F.2d at 102. It must be noted, however, that Wahba's relationship to the case at bar is undermined because the court therein was not faced with an allegation of racial discrimination.
56 496 F.2d at 639.
57 Id. at 640.
58 See note 6 supra.
necessarily be struck between the constitutional right allegedly abridged and the "private" person's right to be free of government intrusion. A discernible pattern does arise, however, upon a close analysis of the state action cases involving alleged racially discriminatory conduct by tax exempt organizations. Several district court holdings, not cited in *Jackson*, differ from those cases carefully chosen as support by the *Jackson* court. Both *Simkins v. Moses H. Cone Memorial Hospital*\(^6^0\) and *Wood v. Hogan*\(^6^1\) involved alleged racial discrimination. In each case, the defendant hospitals not only enjoyed tax exemptions but also had been constructed with the aid of federal funding and were licensed by the state.\(^6^2\) No state action was found in either case, the court in *Simkins* concluding that "the exemption of the defendant hospitals from ad valorem taxes is not a factor to be considered in determining whether the hospitals are public agencies."\(^6^3\) Likewise, the decision in *Guillory v. Tulane University*,\(^6^4\) wherein the plaintiff asserted a violation of his fourteenth amendment rights, strongly dictates against the result reached in *Jackson*. Despite the fact that state officers served as members of defendant's board of directors, tax exemptions were granted,\(^6^5\) the state had a reversionary interest in defendant's property, and the property upon which defendant's university was situated had been transferred from the state, the court found no state action.

As evidenced by the cases relied upon by the *Jackson* majority, viz., *McGlotten*, *Pitts*, and *Falkenstein*, tax exemptions alone have been held to create a sufficient nexus with the state to fall within the purview of the fourteenth amendment only when courts have been faced with an established, formal policy of racial discrimination.\(^6^6\) It

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\(^6^1\) 211 F. Supp. 628 (M.D.N.C. 1962).


\(^6^3\) 211 F. Supp. at 632; 215 F. Supp. at 54.

\(^6^4\) 211 F. Supp. at 636. Similarly, the court in *Wood* summarily held that tax exemption is no indication of state control. 215 F. Supp. at 58.

\(^6^5\) 212 F. Supp. 674 (E.D. La. 1962).

\(^6^6\) With reference to tax exempt status, the court stated, [T]his court is unable to find legal support for the proposition that a simple grant of state funds to a private institution, be it in the form of a tax exemption or otherwise, is state action per se. . . . This court, without specific higher authority, is unable to hold that a simple tax benefit evokes state action. Were that the law then every citizen of the United States and every legal creature would be within the proscription of the Fourteenth Amendment. There is not a scintilla of legal precedent in that direction.

*Id.* at 685.

\(^6^7\) In Smith v. YMCA, 462 F.2d 634 (5th Cir. 1972), the Fifth Circuit found state action, although the tax-exempt defendant's racially discriminatory practices had not been formalized. However, the court found that the defendant's tax exemption was only one of
is important to note the extreme difference in degree between alleging racial discrimination in the failure to make a charitable gift, and the flagrant exclusion of blacks from a fraternal organization pursuant to the organization's bylaws. Additionally, these holdings are far from conclusive since the Court in *Moose Lodge* was faced with identical discriminatory conduct, yet failed to find state action.\(^7\)

Since the *Jackson* court's finding of state action appears unprecedented, the court's application of its five factor test to tax exemptions warrants rigid scrutiny. The panel cited *Norwood v. Harrison*\(^6^8\) and *Green v. Kennedy*\(^6^9\) in determining that tax exemptions generally constitute substantial assistance to charitable foundations. In *Norwood*, however, a state textbook-lending scheme, not tax exemptions, was being challenged. Moreover, in both cases, the courts were faced with an attempt by the state to circumvent an order to desegregate public schools, a situation wherein courts will understandably be more likely to find a basis for state action. Undoubtedly, tax-exempt organizations derive some benefit from the state, as do businessmen who take advantage of business deductions.\(^7\) However, in light of Supreme Court treatment of government benefits in *Moose Lodge* and in *Walz*, it is

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\(^6^7\) Many factors leading to the conclusion that state action was present. In addition to being a tax-exempt organization, the defendant in *Smith* was found to be a monopoly in that it operated the defendant YMCA, and the city maintained an interest in its operation.

\(^6^8\) But see 27 Ark. L. Rev. 146, 150 (1973), where the student author argues that the Lodge Court should have weighed the tax benefits given to private clubs along the state liquor licensing scheme.

\(^6^9\) See, e.g., McGlotten v. Connally, 338 F. Supp. 448, 456 n.37 (D.D.C. 1972), and its cases cited therein. Tax exemptions have been viewed as different in kind from forms of tangible financial assistance from the states. See Lewis, *The Meaning of Action*, 60 Colum. L. Rev. 1083 (1960) [hereinafter cited as Lewis], wherein the author

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\(^7\) May well be that exempting charitable institutions from taxation is not aimed at an economic benefit, but rather that such status is granted because there is no ready way to compute their income, or due to the fact that some private institutions at a loss or at too low a level of income to warrant taxation. See Bittker & Kaufman, *Civil Rights: "Constitutionalizing" the Internal Revenue Code*, 82 Yale L.J. 51, 972 (1973). Unfortunately, this rationale was not considered by the *Jackson* court. This would render a finding of state action totally incongruous with the rationale behind.
doubtful that a tax exemption standing alone can represent the basis for a finding of state action.\textsuperscript{71}

The economic benefit being an insufficient nexus with the state to support a section 1983 claim, the court's second factor, \textit{viz.}, the state's supervisory role with respect to tax-exempt foundations, must be examined. Although racially discriminatory conduct was not alleged in \textit{Walz}, the Court's reasoning therein is enlightening. The Court felt that the tax exemptions created only a minimal involvement between church and state, which involvement would be \textit{less remote} if defendant religious organizations were taxed. A tax exemption, the Court believed, "restricts the fiscal relationship between church and state, and tends to complement and reinforce the desired separation insulating each from the other."\textsuperscript{72} This analysis clearly conflicts with the \textit{Jackson} court's reasoning.\textsuperscript{73} Furthermore, the one substantive limitation embodied in the 1969 Tax Reform Act\textsuperscript{74} which the court found so persuasive was not directed at supervising the awarding of grants in a racially nondiscriminatory fashion. The Act was aimed at preventing various abuses unrelated to racial discrimination.\textsuperscript{75} Accordingly, the racial policies of an exempt foundation are not considered in examinations of its tax returns.\textsuperscript{76}

\textsuperscript{71} The Court in \textit{Moose Lodge} stated: 
\begin{quote}
The Court has never held ... that discrimination by an otherwise private entity would be violative of the Equal Protection Clause if the private entity receives any sort of benefit ... from the State ....
\end{quote}
\textit{407 U.S. at 173}. Significantly, the Court did not consider the tax-exempt status of the defendant organization. Moreover, in \textit{Walz}, Justice Brennan emphasized the all-important difference between tax exemptions and other forms of government assistance. \textit{397 U.S. at 690-91} (Brennan, J., concurring).

\textsuperscript{72} \textit{397 U.S. at 676}. The \textit{Jackson} court cited \textit{Walz} as standing for the proposition that the granting of tax-exempt status to charitable foundations gives rise to a "sustained and detailed administrative relationship ...." \textit{496 F.2d at 630}. In fact, the portion of the Court's opinion so cited is inapposite to the assertion made by the \textit{Jackson} court. The Court was stating that a direct money subsidy would lead to a detailed administrative relationship, but a tax exemption creates no such sustained involvement. \textit{397 U.S. at 675}.

\textsuperscript{73} \textit{But see} \textit{McG bothered v. Connolly}, \textit{338 F. Supp. 448, 459 n.58} (D.D.C. 1972), wherein the court states that the decision in \textit{Walz} regarding the weight to be given tax exemptions is attributable to historical considerations peculiar to the first amendment; Comment, \textit{Tax Incentives As State Action}, \textit{122 U. Pa. L. Rev. 414, 424-25} (1973) [hereinafter cited as Comment].

\textsuperscript{74} \textit{26 U.S.C. § 4945(g)} (1970) (mandating the award of grants "on an objective and nondiscriminatory basis").


\textsuperscript{76} \textit{See} \textit{Simon, Foundations and Public Controversy: An Affirmative View, in The Future of Foundations} 58, 89 (1973), where the author favors the Internal Revenue Service's accountability requirements as applied to exempt organizations because such supervision
As to the third requirement for state action, whether or not tax-exempt status connotes government approval of an organization's activities is a tenuous test. A favorable IRS ruling might only indicate that a given foundation has been successful in cutting through governmental red tape.\textsuperscript{77} In granting such status, the IRS merely stipulated that the applicant falls within the broad definition of "charitable" set forth in the Internal Revenue Code.\textsuperscript{78} One may conclude that such approval is value neutral with respect to the programmatic aspects of the exempted organization.

Finally, it is arguable that, with the increasing number of government welfare programs and social agencies in recent years, the activities of private foundations overlap into areas now regarded as "public functions." Yet, the importance of private philanthropy has been widely regarded as residing in its freedom to act innovatively, even controversially,\textsuperscript{79} in making a valuable contribution to American pluralism.\textsuperscript{80} In holding that their grant-making is subject to the same restraints imposed on governmental action, the Jackson court diminished the ability of private foundations to fulfill their unique purpose.\textsuperscript{81} Tax scholars are in disagreement concerning the adverse impact of the 1969 Tax Reform Act on private philanthropy,\textsuperscript{82} but one spokes-

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\textsuperscript{77} See Comment, supra note 73, at 464, where the author states that the supervisory role of the IRS has become more active due to the Tax Reform Act of 1969 and suggests that in the future more control may be exercised over programmatic aspects of exempted organizations.


\textsuperscript{79} See, e.g., Hart, supra note 37. One author proposes that due to the relative freedom enjoyed by private foundations, they may well have an obligation to involve themselves in controversial fields. F. Andrews, Philanthropic Foundations 11, 19 (1956).


\textsuperscript{81} The opinion that private philanthropy's greatest asset is its freedom from governmental restraints has been widely expressed. See, e.g., Andrews, Introduction, in Foundations: 20 Viewpoints 5, 6 (1965); Bitker, The Propriety and Vitality of a Federal Income Tax Deduction For Private Philanthropy, in Tax Impacts on Philanthropy 145, 167 (1972).

\textsuperscript{82} Some authors believe the 1969 Tax Reform Act has had a minimal effect on the activities and financial outlook of private foundations. See, e.g., Kurz, Treasury's Experience and Views, in Tax Impacts on Philanthropy 23, 25 (1972) [hereinafter cited as Kurz]. This authority does, however, leave open the question whether the Act will impede private philanthropy in the future. Other commentators fear the Act will have a negative effect on the formation of new foundations. See Kunen, Effects of Act, in Tax Impacts on Philanthropy 127 (1972). Various foundation representatives have testified to the adverse effects already apparent. See Chance, Operational Effects and Dressner, Learning To Live With the Tax Reform Act, in Tax Impacts on Philanthropy 121 (1972). See also Labovitz, 1969 Tax Reforms Reconsidered, in The Future of Foundations 101 (1973).
man for the Council on Foundations\textsuperscript{83} optimistically observed that the Act still allowed foundations considerable flexibility. This flexibility, however, has been seriously limited by the \textit{Jackson} decision.\textsuperscript{84}

By finding that the conduct of defendant foundations constituted state action for purposes of the plaintiff's section 1983 claim, the court was attempting to eradicate the discriminatory distribution of grants. Such a laudable purpose, however, does not serve to explain the court's decision. No proof existed that the defendants practiced racial discrimination; rather, the record disclosed that defendants had given generously to all races. Yet, the court seized upon this opportunity to espouse a novel, far-reaching extension of the state action doctrine. No lower federal court had gone to this extreme, and the Supreme Court, in \textit{Moose Lodge}, appears to have brought a halt to the continued expansion of the state action doctrine.\textsuperscript{85}

Aside from the absence of judicial precedent, the \textit{Jackson} holding appears unwarranted when one considers its possible adverse effect on the workings of charitable institutions. The vast majority of grants are made by small foundations in communities\textsuperscript{86} where contributions to the arts, local charities and hospitals have a visible impact on local constituencies.\textsuperscript{87} They serve as a valuable alternative to Washington-based Government agencies over which local initiative has no control.\textsuperscript{88} The current fear is that if these small foundations do not act innovatively to fulfill their unique potential, they will be emasculated by amorphous government programs.\textsuperscript{89} At such an important milestone in the evolving life of American private philanthropy, the \textit{Jackson} court has effectively roadblocked the path to innovation and experimentation. Hopefully, other courts, cognizant of the dearth


\textsuperscript{84} One detailed study of the 1969 Act, cited by the court, strongly dictates against the imposition of additional restraints. The author of the study believes the strictures currently embodied in the Act seriously threaten the survival of private foundations. \textit{Private Foundations}, supra note 75, at 268-75. Increased administrative expenses incurred by virtue of the new reporting scheme were felt to threaten private foundations already in existence. Additionally, the Act may give rise to investment cautiousness resulting in an overall reduction in monies for charitable endeavors. Those involved in innovative fields will now gravitate toward more traditional undertakings, and many incentives for beginning a new foundation have been destroyed. Indeed, many small foundations may well terminate their status. \textit{See also} Etherington, \textit{Effect on Donees}, in \textit{TAX IMPACTS ON PHILANTHROPY} 67, 70-71 (1972).

\textsuperscript{85} \textit{See} note 13 supra.


\textsuperscript{87} \textit{Id.} at 168.

\textsuperscript{88} \textit{Id.} at 181.

\textsuperscript{89} \textit{Id.} at 167.
of legal precedent, and mindful of the deleterious consequences, will not adhere to the ill-conceived state action theory devised by the \textit{Jackson} panel.

\textit{Kate Monica Walsh.}