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PROPOSED INTERNAL REVENUE SERVICE PROCEDURE REGARDING REVOCATION OF TAX EXEMPT STATUS FOR PRIVATE SCHOOLS WHICH DISCRIMINATE ON THE BASIS OF RACE*

DAVID L. ANDERSON

INTRODUCTION

On August 22, 1978, the Internal Revenue Service proposed revenue procedures which would govern revocation of IRC section 501(c)(3) tax-exempt status of private schools which discriminate on the basis of race. In view of the large number of religious schools which could be potentially affected by increased IRS scrutiny of racial policy in private education, this issue warrants a thorough discussion giving particular attention to First Amendment problems and possible abridgment of the constitutional rights of religious educational institutions.

II. THE LEGAL BASIS OF IRS AUTHORITY TO DENY TAX EXEMPTION TO PRIVATE SCHOOLS WHICH DISCRIMINATE

Section 501(c)(3) of the Internal Revenue Code exempts organizations "organized and operated exclusively for religious, charitable, . . . or educational purposes." For more than fifty years after the establishment of the Internal Revenue Service, favorable tax status was allowed to educational institutions without regard to a school's particular racial, social, or philosophical position. As a result of the constitutional doctrine permitting separate but equal educational facilities, denial of tax benefits was never

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considered, either judicially or administratively. In 1954, however, the “separate but equal” doctrine was overturned in Brown v. Board of Education, and racial discrimination in public education was ruled illegal and contrary to public policy. In 1965, the IRS suspended rulings to private schools while considering the question of the effect of racial discrimination on their tax-exempt status. In 1967, it announced its position that racially discriminatory private schools were not entitled to tax-exempt status, but limited the ruling to those schools receiving state aid. Thus, prior to 1970, the Internal Revenue Service continued to recognize as tax-exempt racially discriminatory private schools which were not receiving state aid.

The IRS policy of non-intervention was first challenged in 1970 in Green v. Kennedy. In this suit, black taxpayers in Mississippi and their minor children alleged that exempt status was illegal and unconstitutional to the extent that it supported the establishment and maintenance of segregated private schools. In its decision, the district court found that a substantial constitutional right was involved and that granting tax-exempt status to an organization which discriminated against minorities frustrated the constitutional mandate of a unitary educational system by providing government support for a racially segregated dual school system.

In response, the IRS issued two press releases stating that it would no longer grant tax-exempt status to schools which maintained racially discriminatory admissions policies. The reasoning of the IRS was that all organizations under section 501 and all contributions pursuant to IRC section 170 had to first qualify as “charitable” under the common law. Since federal policy is against racial discrimination, and all charities must be in accord with federal public policy, private segregated schools cannot qualify as a charity within the meaning of section 501.

Following the issuance of the IRS ruling, the District Court for the District of Columbia convened a three judge panel to make permanent the temporary injunction issued in Green v. Kennedy. In its deliberation, entitled Green v. Connally, the court set forth a declaratory decree, reasoning that the changed position of the Service would not provide sufficient relief for the plaintiffs, since its interpretation of the Code could change in the future. Relying on the Civil Rights Act of 1964, the decisions of the Supreme Court banning racial segregation in public schools, and the post-Civil War amendments to the Constitution, the court found that there was a federal policy against government support for racial segregation of public or private schools. Thus, since the Code, as well as federal public policy,

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4 309 F. Supp. at 1137.
8 Id. at 1163-64.
was opposed to support for racial segregation of schools, the court ruled that the Code did not provide tax exemption for private schools that have racially discriminatory policies, and permanently enjoined the service from approving the exemption of any private school in Mississippi that failed to make a specifically required showing in support of its exemption.\textsuperscript{10}

As a result of \textit{Green} and other case law striking down tax exemptions for discriminatory private organizations\textsuperscript{11} the IRS felt that it had a statutory and constitutional basis to implement a nondiscrimination requirement. In 1971, Revenue Ruling 71-477\textsuperscript{12} was published. It explained the nondiscrimination requirement, stating that a private school with a racially discriminatory policy as to students did not qualify for exemption. In 1972, Revenue Procedure 72-54\textsuperscript{13} set forth guidelines for certain private schools claiming tax exemption to publicize a racially nondiscriminatory policy. Revenue Ruling 75-50,\textsuperscript{14} published in 1975, required all tax-exempt private schools to adopt formally a nondiscrimination policy in their charter, bylaws, or governing instrument, to refer to the policy in all brochures and catalogs, and to publish notice of the policy annually by newspaper or by use of the broadcast media. Schools were also required to maintain records showing factors relevant to their racial composition.

Civil Rights groups and the Civil Rights Division of the Department of Justice, however, questioned whether Revenue Procedure 75-50 enabled the Service to determine whether a school had actually established a policy of non-discrimination as required by the \textit{Green} court. Even after the promulgation of Revenue Procedure 75-50, the IRS declared itself unable to revoke the exemptions of private schools which have been specifically adjudicated by federal courts to be racially discriminatory as long as the

\textsuperscript{9} \textit{Id.} at 1164.

\textsuperscript{10} \textit{Id.} at 1170-71. The court avoided a direct ruling on the constitutional claim that the due process clause of the fifth amendment prohibited the federal government from providing financial support through tax benefits to institutions that discriminate on the basis of race. The Code does not contemplate the granting of special federal tax benefits to trusts or organizations, whether entitled to the special state rules relating to charitable trusts, whose organization or operation contravene federal public policy. \textit{Id.} at 1162. The court did note, however, that all charitable trusts, educational or otherwise, must be legal and in compliance with public policy. \textit{Id.} at 1161.

\textsuperscript{11} In McGlotten v. Connally, 338 F. Supp. 448 (D.D.C. 1972), the court applied the nondiscrimination requirement beyond the educational context to other nonprofit organizations entitled to tax benefits under the Code. The court sustained the constitutional challenge to beneficial tax treatment for racially exclusive fraternal orders and found that the Government had become sufficiently entwined with the private parties to ensure compliance with the fifth amendment. \textit{Id.} at 456-57. In its ruling the court considered the public nature of the activity, the degree of regulatory control in determining the organization which may qualify for beneficial tax treatment, and the aura of government approval in an IRS exemption ruling. Thus, \textit{McGlotten} struck down the deduction provisions for contributions both to nonprofit private clubs and to fraternal organizations that discriminate on the basis of race.


\textsuperscript{13} Rev. Proc. 72-54, 1972-2 C.B. 834.

schools published a pro forma statement of a contrary policy.\textsuperscript{15}

Nevertheless, in 1976 the Congress endorsed the rationale of the \textit{Green} decision by adding section 501(i) to the Internal Revenue Code. The section denies exempt status to social clubs which "discriminat[e] against any person on the basis of race, color, or religion."\textsuperscript{16} The Senate report explaining the legislation indicated the Congressional understanding that \textit{Green} \textit{v. Connally} remains the law for educational institutions tax exempt under section 501(c)(3) and for the contributions of donors under section 170(c)(2).\textsuperscript{17}

Another significant development was the publication of Revenue Ruling 75-231,\textsuperscript{18} which stated that private schools operated by churches, like other private schools, shall not be tax exempt if they are racially discriminatory. This enactment represented the IRS' complete acceptance of the idea that the holding of \textit{Green}, which mandates revocation of tax-exempt status for any private school discriminating on the basis of race, extends to religious schools. The permissibility of such an interpretation under the Constitution, and the related question of the constitutionality of certain provisions of the IRS procedures designed to carry it into effect, should be next considered.

\textbf{The IRS Revenue Procedure and the Constitutional Rights of Affected Schools}

\textit{IRS Proposal Revenue Procedure}

Before studying the perplexing constitutional issues, it is necessary to survey the main provisions of the IRS Revenue Procedure governing revocation of tax-exempt status. The original rules proposed by the Service pursuant to the mandate of the \textit{Green} line of cases divided private schools into three classes: "adjudicated schools," "reviewable schools," and "others."\textsuperscript{19} A "school adjudicated to be discriminatory" meant any private

\textsuperscript{15} Since the publication of Rev. Proc. 75-50, the IRS has revoked the tax exemption of only one private school. This school refused to adopt even a pro forma policy of nondiscrimination. During this time the Service did not move against 20 schools which have been adjudicated discriminatory which did adopt pro forma policies. Statement by Stuart E. Siegel, IRS Chief Counsel, Tax Institute, Stonybrook, N.Y. (Oct. 21, 1978).


\textsuperscript{17} S. REP. No. 94-1318, reprinted in [1976] U.S. CODE CONG. & AD. NEWS 6051, 6058 n.5. In Runyon \textit{v. McCrary}, 427 U.S. 160 (1976), the Supreme Court held that two privately owned and operated schools, which received no public financial support, violated § 1 of the 1866 Civil Rights Act, 42 U.S.C. § 1981 (1976), when they refused to accept black students for admission. The Civil Rights Act of 1866, enacted in accordance with the authority of Congress to legislate under the thirteenth amendment, has been held to bar both public and private interference with contractual rights. By applying the Civil Rights Act to private schools and finding that parental rights to neither privacy nor free association supersede the bar against segregation in public contracts, \textit{Runyon} enunciated the strong public policy against racial discrimination and reinforced the \textit{Green} decision.

\textsuperscript{18} Rev. Rul. 75-231, 1975-1 C.B. 158.

\textsuperscript{19} 43 Fed. Reg. 37,296 (Aug. 22, 1978) (proposed § 3).
school found to be discriminatory in a final court or administrative agency decision. A "reviewable" school was defined as any private school which, though never adjudicated discriminatory, was formed or substantially expanded at about the same time as desegregation was put into effect in the public schools serving a particular community. Such expansion was said to justify an inference of discrimination if the school did not have a minimum percentage of minority students, which would be twenty percent of the minority school age children in the community served by the school. "Other school" meant a school "neither adjudicated to be discriminatory" nor "reviewable."

For the "adjudicated" and "reviewable" schools, objective standards were set forth which the schools had to meet to rebut the adjudication or inference of discrimination. The basic standards to rebut the adjudication or inference were: (1) the presence in the school's student body of a minimum number of minority students, or (2) the presence of four out of five indices of good faith operation, i.e., significant financial aid to minority students, vigorous minority recruitment programs, an increasing percentage of minority students, employment of minority teachers, and "other substantial evidence of good faith." Even if four out of five indices were met, however, the inference of discrimination would generally not be rebutted if the school did not enroll any minority students.

If the private school thus failed to rebut an adjudication or inference of discrimination under the original proposed procedures, the Service would revoke its tax exemption and suspend advance assurance of the deductibility of contributions. The school could prevent this prompt revocation, (but not the suspension of advanced assurance) by requesting a grace period and agreeing to meet the standard within a reasonable period, two school years or less. If the school failed to meet the standards during the grace period, its tax exempt status would be retroactively revoked and all contributions made since the suspension of advance assurance would be denied deductibility.

Following the publication of the proposed revenue procedure on August 22, 1978, the Internal Revenue Service received over 100,000 letters of public comment. After consideration of these comments, on February 9, 1979, the IRS issued a revised version of the proposed guidelines, in which it more narrowly defined "adjudicated" and "reviewable" schools. In addition, it substantially increased its discretion in determining whether a private school has rebutted an inference or adjudication of racial discrimination.

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20 Id. at 37,297 (proposed § 3.02).
21 Id. (proposed § 3.03).
22 Id. at 37,297-8 (proposed § 4).
23 Id.
24 Id. at 37,298 (proposed §§ 4.01(2), .02(2)).
25 Id. (proposed § 5).
The definition of reviewable schools is significantly narrowed by the addition of a new third factor. To be reviewable, it must be a school where formation or substantial expansion is “related in fact to public school desegregation in the community.” The revised version of the rules goes on to set forth seven examples of specific facts which would tend to indicate the lack of a relationship in fact to school desegregation and seven examples of facts which would support a relationship.

The definition of “reviewable schools” is further narrowed by providing that a one-year increase in students of twenty percent or less (as compared with ten percent previously) will not be considered “substantial expansion” and by providing that the determination whether a school’s minority enrollment is insignificant will be based on all the relevant facts and circumstances, with consideration given to special factors which limit the school’s ability to attract minority students. An example of such a factor would be an emphasis, for non-discriminatory purposes, on specific programs or curricula which interest only groups not composed of significant numbers of minority students, e.g., Hebrew or Amish schools. In addition, the revised Procedure provides that where a school is part of a large system of commonly supervised schools, and the particular school does not meet the enrollment criteria, it may still be deemed to have met the requirement if the minority enrollment throughout the system satisfies the proposed numerical standard and if certain other standards are fulfilled.

While the time frame for determining whether the formation or substantial expansion of a school are suspect remain the same (one year before and three years after desegregation), the revised version considers the time of desegregation to be when substantial implementation of the relevant desegregation order takes place. This limits the duration of the suspect desegregation period in comparison to the original version where the period was to continue until three years after final implementation of the desegregation plan. An additional technical change occurred in the definition of the “community” served by the private school. The community remains the public school district in which the school is located, but includes additional districts only if the school enrolls at least twenty percent (as compared to five percent) of its students from them.

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27 Id. at 9,452 (proposed § 3.03).
28 Id. at 9,453 (proposed § 3.03(c)).
29 Id. (proposed § 3.03(a)).
30 Id. (proposed § 3.03(b)).
31 Id. (proposed § 3.03(c)(6)).
32 Id. (proposed § 3.03(b)).
34 44 Fed. Reg. 9,451, 9,453 (Feb. 13, 1979) (proposed § 3.03(a)).
37 Id.
Under both the original and revised revenue procedures, if a school is classified as "adjudicated" or "reviewable," the burden of proof shifts, and it is called upon to show it has taken actions or programs reasonably designed to attract minority students on a continuing basis. Instead of requiring a definite standard of four out of five indices of good faith, six examples of actions which may contribute to attracting minority students are listed and the level of action required can vary with circumstances of the school depending upon its minority enrollment. Thus, under the revised Procedure, the standards are much more flexible for rebutting an adjudication or inference of discrimination.

Revocation of Tax-Exempt Status and the Establishment Clause

All branches of the government are constrained by the first amendment's Establishment Clause. In *Walz v. Tax Commission*,[4] for instance, the Supreme Court held that the existence of religious exercise must be permitted without sponsorship or interference. On first glance, it would seem that the IRS guidelines affect an establishment of religion by giving more favorable tax treatment to denominations which do not discriminate than those whose beliefs require them to do so.

The Constitution does not speak directly to the question of the taxation of churches or the regulation of their conduct by the granting of a tax-exempt status. Nor has the Supreme Court specifically ruled whether taxation of churches would violate the Constitution. However, the Court has considered related questions in cases involving the first amendment establishment clause.

In *Committee for Public Education v. Nyquist*[5] and *Lemon v. Kurtzman*,[6] the Supreme Court summarized the elements necessary to determine whether legislation is in conflict with the establishment clause. The law must have a secular purpose, must not have the principal or primary effect of advancing or inhibiting religion, and must not foster excessive government entanglement with religion.[7] The failure of any of these tests may result in the statute or program being contrary to the establishment clause. In the analysis of the proposed guidelines under the three-pronged test, the court must first find a legitimate secular purpose. In the case of the IRS procedures, the purpose would be the federal public policy against racial discrimination in education. Additionally, the courts generally tend to sustain, without inquiry as to motive, tax legislation with a revenue-raising purpose.

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[4] Id. at 9,454 (proposed § 4); 43 Fed. Reg. 37,296, 37,297 (Aug. 22, 1978) (proposed § 3.03).
Courts have differed, however, whether particular examples of exemption revocation were sufficiently supported by secular considerations. In Goldsboro Christian Schools, Inc. v. United States,\(^4\) the court held that a discriminatory private school is not entitled to tax exemption, notwithstanding the religious belief on which it bases its racially discriminatory admissions policy. The court stated that there was a legitimate secular purpose for denying tax-exempt status to schools maintaining a racially discriminatory admissions policy. The court viewed the general denial of tax benefits to such schools as neutral since the primary effect would be to implement the recognized policy against discrimination.

In juxtaposition to the Goldsboro case, Bob Jones University v. United States\(^7\) held that the revocation by the IRS of the tax-exempt status of a university practicing racial discrimination was improper. The court concluded that revocation of the benefit conferred on the university through tax exemption could not be justified by the public's interest in fighting racial discrimination, finding that the tax benefits involved did not in fact encourage the university to discriminate against minorities. Commentators have been critical of this decision, since, in their opinion, it misconstrues the rationale of the Green court. In their view, Green did not hold that the public policy against racial discrimination barred the continuance of only those government actions which encourage discrimination, but rather that any form of government aid, even indirect aid to discriminatory educational institutions, was unacceptable because it would involve governmental financial support for illegal activities.

Under the second prong of the three-part test, the denial of tax benefits to schools which practice racial discrimination must be an essentially neutral act.\(^8\) Since the guidelines are not directed at religious schools alone, the potential results of their implementation must be carefully examined to determine if their primary effect would be to inhibit the exercise of religion.

According to the revised Revenue Procedure, the IRS, in its determination of a "reviewable school," is to consider whether

[t]he school was formed or expanded in accordance with a long-standing practice of a religion or religious denomination which itself is not racially discriminatory to provide schools for religious education when circumstances are present making it practical to do so (such as a sufficient number of persons of that religious belief in the community to support the school), and such circumstances are not attributable to a purpose of excluding minorities.\(^4\)

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\(^4\) Id. at 1320.
\(^8\) Roehmer v. Board of Public Works, 426 U.S. 736 (1976); see notes 42-44 and accompanying text supra.
\(^4\) 44 Fed. Reg. 9,451, 9,453 (Feb. 13, 1979) (proposed § 3.03(c)(6)).
This consideration could be construed to violate the principle of government neutrality in several ways. According to this guideline, the Catholic Church, because of its long history of religious education, could expand or form schools with less likelihood of being adjudicated racially discriminatory than those of another faith. The IRS has the authority to define a "long standing practice of religion" and can give preference to denominations which have operated schools in the past over those which seek to establish them in the future. Stretched to its logical limits, such a consideration oversteps the boundary of government established in United States v. Ballard, where the Supreme Court held that men cannot be required to prove their religious doctrines or beliefs. As the Court declared, "[t]he First Amendment does not select any one group or any one type of religion for preferred treatment." Later, in Flounler v. Rhode Island, the Supreme Court went on to hold that it was not the business of the courts to determine whether a religious practice or activity for one group was a first amendment-protected religion for another.

In contrast, it should be noted that the Supreme Court has adopted a practical approach to tax cases, tending not to invalidate legislation under the "primary effect" test because of possible incidental consequences. For example, the taxation of newspapers may threaten freedom of the press, yet it has never been struck down on first amendment grounds. Since the guidelines are not directed at religious schools alone nor designed to limit their operation, it would be difficult to assert that the primary effect of the guidelines would be to inhibit religion.

The third part of the establishment clause test is whether the proposed regulation fosters excessive government entanglement with religion. Even though no explicit ruling has been made, dicta in Walz v. Tax Commission, which sustained tax exemption for religious property, implied that taxation of churches or religious organizations might be unconstitutional. In Walz, the Supreme Court noted that the test is really one of degree, because both taxation and exemption of churches involves some degree of government involvement with religion. The Court held some government involvement was inevitable with a tax exemption, but that this caused less entanglement than taxation would. Of particular concern was avoiding substantive governmental evaluation of religious practices

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32 U.S. 78 (1944).
345 U.S. 67 (1953).
322 U.S. 78 (1944).
Id. at 86.
Id. at 87.
Id. at 69-70.
Id. at 674.
Id.
and the entanglement of government and difficult classifications of what is and is not religious.  

The resulting relationship between government and the religious organization was the essential factor used by the Walz Court in determining whether the administrative entanglement with religion brought about by the various courses of action in the taxation area would be excessive. Danger of excessive entanglement exists if continual government surveillance becomes necessary to police the program, if the government must become involved in church decisions, or if annual audits are required. While the surveillance necessary to enforce the proposed revised Revenue Procedure would not require continual surveillance or government involvement in decisions, annual audits might become necessary. In light of Roemer v. Board of Public Works, however, it is unclear whether annual audits would be sufficient to invalidate the guidelines. In Roemer, the Supreme Court approved occasional audits of nonpublic colleges to determine their use of state aid where the audits were quick and non-judgmental and similar to those used for state accreditation.  

According to Walz, the establishment clause should protect religious organizations from active government involvement in religious activity. In sum, however, there appears to be a strong argument to the effect that the IRS guidelines could withstand an attack on establishment clause grounds.

Revocation of Tax-Exempt Status and the Free Exercise Clause

In addition to the establishment clause, the first amendment provides protection for religious schools through the free exercise clause. To sustain a free exercise argument, it is necessary to show that an enactment has a coercive effect upon individuals in the practice of their religion. When confronted with the claim that government action infringes an individual's religious liberty, a court must balance the competing interests of government regulation and religious liberty. The government may only regulate the conduct of its interest is compelling, non-discriminatory, narrowly related to the public interest, and the least restraint that would serve the purpose.

Private religious education has been found to be a protected religious activity. As a result of religious influence in the teaching of secular sub-

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60 Id. at 698 (Harlan, J., concurring).  
63 397 U.S. at 727.  
TAX EXEMPT STATUS

jects, the Supreme Court found it could not approve funding of any instruction in private religious schools. Logically, if the education in the private schools is so religious as to violate the establishment clause when public funds are granted to the schools, then the religious nature of this instruction is in turn entitled to the protection guaranteed to religion by the free exercise clause.

If education is a religious liberty interest, and the IRS guidelines have a direct or indirect effect upon the religious interest, the balancing test must be applied: "[O]nly a compelling state interest in the regulation of a subject within the State's constitutional power to regulate can justify limiting First Amendment freedoms."88 The strict restriction on intrusions was enforced in Thomas v. Collins:89 "[O]nly the gravest abuses, endangering paramount interests, give occasion for permissible limitation."70 Finally, Wisconsin v. Yoder71 set forth the principle "that only those interests of the highest order and those not otherwise served can overbalance legitimate claims to the free exercise of religion." Extending the proposed procedures to their logical limit, they enter this delicate area by attaching tax consequences to a religious school's ability to admit or deny admission to any student, as well as the school's ability to hire and fire teachers based on a particular religious belief. The Supreme Court has never addressed this question.

The permissibility of the proposed guidelines therefore should not be blindly taken for granted. Government involvement in church affairs may rise to the level of entanglement where free exercise would be threatened. Taxation alone, however, is not sufficient to raise the entanglement question. Religious organizations have lost their tax exempt status in the past for failure to comply with statutory requirements for exempt organizations,73 and in view of the considerable importance courts are likely to attach to the compelling state interest in preventing race discrimination, the Free Exercise argument may not be a strong one.

Freedom of Association

In Green v. Connally, the court specifically addressed whether the

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89 323 U.S. 516 (1945).
90 Id. at 530.
92 Id. at 215.
rights of private schools under the first amendment would restrain it from ordering the IRS to revoke a school’s tax-exempt status if it did not satisfy the standards for disproving a discriminatory policy. Rejecting a freedom of association claim, the court stated that a right to be free from government regimentation, including the right to attend private schools, did not imply a right to financial support:

[E]xemptions and deductions would be denied not on account of beliefs and associations but on account of acts and practices constituting discrimination among students on account of race — acts contrary to a national policy that has constitutional ingredients.\textsuperscript{74}

Even statutory classifications which affect a fundamental right are valid when they are “shown to be necessary to promote a compelling governmental interest.”\textsuperscript{75} The compelling and reasonable interest in combating racial discrimination stands on the highest constitutional ground. The Green court found the government interest in banning racial discriminations “dominant over other constitutional interests to the extent that there is complete and unavoidable conflict.”\textsuperscript{76} The court argued, therefore, that if a compelling interest exists strong enough to overcome one fundamental first amendment right, it should also be sufficient to overcome a distinct but similar right.

THE TWENTY PERCENT STANDARD OF THE IRS PROCEDURE AND THE Bakke DECISION

The revised Revenue Procedure may violate the Supreme Court’s decision in \textit{Regents of the University of California v. Bakke},\textsuperscript{77} since its guidelines may require schools to use race-conscious criteria in determining admissions policies. In \textit{Bakke}, the Supreme Court invalidated the minority quota admissions program at a medical school on the basis of the fifth and fourteenth amendments. A majority of the court disallowed the imposition of racial goals, or other forms of specific race-conscious relief, unless specific findings of past discrimination by the courts, Congress, or competent administrative tribunals existed.\textsuperscript{78}

The percentage goal mandated by the proposed guidelines can be read to require that a school enroll a prescribed percentage of minority students or be found to be presumptively discriminatory. Further, according to the guidelines, a school will seldom qualify for a tax exemption unless it enrolls some minority students, no matter how substantial the rebuttal evidence that it operates on a non-discriminatory basis. Thus, the validity of the

\textsuperscript{74} 330 F. Supp. at 1166.
\textsuperscript{75} Shapiro v. Thompson, 394 U.S. 618, 634 (1969).
\textsuperscript{76} 330 F. Supp. at 1167. Where there is a compelling government interest, even first amendment freedoms may be limited by appropriately confined lesser measures, although they could not be prohibited directly. Shelton v. Tucker, 364 U.S. 479, 487-90 (1960).
\textsuperscript{77} 438 U.S. 265 (1978).
\textsuperscript{78} Id. at 307-10.
numerical standards in the guidelines may depend on whether they are supported by adequate judicial or administrative findings of discrimination as required in Bakke.

According to the guidelines, apart from a final court adjudication, two factors can provide the basis for the revocation of a school's tax-exempt status. One is a statistical disparity in the racial composition of the school as compared to the school age population of the community. The other is the formation or expansion of the schools at the time of public school desegregation in the community. From Bakke, it is unclear whether the existence of the factual setting described in the guidelines would meet the test of "findings of identified discrimination" or whether an individualized agency determination on a school-by-school basis is required before numerical goals become permissible.

In opposition to the guidelines, it can be argued that the Supreme Court has begun a trend toward stricter standards regarding proof of discriminatory intent and reluctance to use traditional evidentiary presumptions like those employed in the proposed guidelines. Thus, in Swann v. Charlotte-Mecklenburg Board of Education, the Supreme Court held that while the existence of one-race, or virtually one-race, schools in a particular school system continues to be constitutionally suspect, the constitutional demand to desegregate schools does not require every school in the community always to reflect the racial composition of the school system as a whole. Further, Washington v. Davis held that the racial impact of an act alleged to be racially discriminatory does not per se constitute an equal protection violation where there was no showing of a racially discriminatory purpose. The Supreme Court also has rejected a desegregation plan for the Dayton, Ohio schools which was based on the district court's finding that the schools in the district were racially imbalanced. The Court held that the lack of homogeneity of the pupil population of the Dayton schools was not of itself a violation of the fourteenth amendment without a showing of intentional segregative actions by the school board. Accordingly, a proven intentional constitutional or statutory violation must be shown before preferential classification of one race over another can be sustained.

In contrast, disparity between the racial make-up of the school and the community, taken together with the factor of the school's expansion during the implementation of desegregation, may perhaps be said to provide sufficient circumstantial evidence of past discriminatory intent to meet the current constitutional standards. In Village of Arlington Heights v. Metropolitan Housing Development Corp., the Supreme Court concluded that while racial impact does not itself indicate invidious discrimination,

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80 Id. at 26.
it may be probative when viewed against the entire sequence of events in the challenged action. Thus, an inference of discrimination may be sustained where the impact of enrollment decisions by tax exempt private schools as reflected in their racial student composition occurs contemporaneously with public school desegregation.

An additional consideration centers on the differing role of government. Allen Bakke filed suit because he was denied admission to medical school at the same time minority students with lower academic records than he had were admitted as a result of the special admissions program. In the Revenue Procedure, the twenty percent “safe harbor” does not deny admittance to qualified white students at private schools. Instead, the twenty percent requirement only sets forth that a particular school will not be exempt from certain federal taxes unless the twenty percent standard is satisfied. It can be argued, then, that the Bakke decision is not controlling. It is concerned with the situation where government itself attempts to alleviate the effects of past discrimination by use of a quota-type special admissions, while the twenty percent standard of the Proposed Procedure uses numerical standards not to determine who will be admitted to an educational institution, but rather whether that education shall be tax-exempt.

The Irrebuttable Presumption Doctrine

Constitutional issues also arise from the Procedure’s use of evidentiary presumptions of discrimination. Although there undeniably exists a longstanding policy permitting the use of presumptions in the discrimination cases, the Procedure presents the difficult situation where use of such a presumption impacts upon the right of religious liberty.

A most significant case holding a private school with tax exempt status to be racially discriminatory is Norwood v. Harrison. In determining the eligibility of seven individual schools to receive aid under a state textbook program to private schools, the court noted that it was well settled in racial desegregation cases that the parties alleging discrimination need only make a prima facie case, after which “the burden shifts to the school’s officials or representatives to rebut an inference of racial disparity.” This view is supported by Hodgson v. First Federal Savings and Loan Association.

In discrimination cases the law with respect to burden of proof is well settled. The plaintiff is required only to make out a prima facie case of unlawful discrimination at which point the burden shifts to the defendant to justify the existence of any disparities.

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85 382 F. Supp. at 924.
86 Id. at 925.
87 455 F.2d 818 (5th Cir. 1972).
88 Id. at 822.
Norwood went further to define specific facts which would be sufficient to constitute a prima facie case of racial discrimination:

(a) that the school's existence began close upon the heels of the massive desegregation of public schools within its locale, and (b) that no blacks are or have been in attendance as students and none is or ever has been employed as a teacher or administrator at the private school.99

In addition, Brumfield v. Dodd90 provides support for the concept of shifting the burden of proof as found in the Revised Procedure. In Brumfield, a U.S. district court in Louisiana held seventy private schools in that state racially discriminatory in spite of the state certification process, and thus ineligible for state textbook assistance. The Brumfield court relied extensively on the Norwood decision.

While the Proposed Procedure parallels Norwood's focus on schools formed at or about the time of racial desegregation, it also covers schools substantially expanded at the time of the desegregation, an area not included in Norwood's general statement of a prima facie case. Although none of the private schools in either case involved substantial expansion, however, the Norwood and Brumfield courts made clear that a substantial expansion was equally suspect.91 The second difference between the Norwood court and the Proposed Procedure is the court's requirement that there be a total absence of minority students or facility for the inference to attach. Thus, in this instance, the IRS has gone beyond the criteria with clear support in the relevant judicial decisions.

The Revised Procedure is in accord with the Norwood court in applying a flexible standard and objective indices of non-discrimination in rebutting a prima facie case of discrimination. For each of the seven private schools in question, the Norwood court required varying amounts of refutation specifically corresponding with the force of the original prima facie case. The Proposed Procedure follows this by requiring that "[t]he level of actions and programs that are adequate may vary from school to school and depends on the circumstances of the school."92

The concept of shifting the burden of proof is further substantiated by the general rule that the burden of proof in tax controversies falls upon taxpayers and tax-exempt organizations, as for example, when taxpayers must substantiate deductions which are questioned by the Service.93 Further, a claim of tax-exempt status is not to be granted unless material facts supporting such status are proven by the entity claiming the status.94 While, in criminal tax cases, the burden is on the Government to prove the criminal tax offense beyond a reasonable doubt, in civil litigation the de-
termination of the IRS is presumed to be correct and the taxpayer must meet the burden of overcoming that presumption.

Opponents have argued that the Revenue Procedure has established fixed standards against which certain private schools are always to be scrutinized. These standards are unalterable even though private schools which lose their tax-exempt status when judged against those standards have the opportunity to litigate the Service’s determination. Thus, even though procedural due process requirements are met by providing adequate appeal rights, the procedures, if they establish an irrebuttable presumption against certain schools, may still not satisfy the requirements of the due process clause.

This same type of objection to an irrebuttable presumption was upheld in *Heiner v. Donnan,* where the Supreme Court overturned a federal estate tax statute, which made a conclusive presumption that gifts made within two years prior to the donor’s death were made in contemplation of death, thus requiring payment of a higher estate tax. The Court held this irrebuttable presumption so arbitrary it deprived a taxpayer of property without due process of law. An irrebuttable presumption was also successfully challenged in *Stanley v. Illinois,* where a statutory presumption that all unmarried fathers were not qualified to raise their children was overturned. Finally, in *Cleveland Board of Education v. LaFleur,* the Supreme Court held unconstitutional a local board of education’s rule requiring pregnant teachers to take maternity leave without pay before and after the birth of a child on the grounds that they were presumed physically unfit.

Some standards which amount to irrebuttable presumptions, however, are constitutional. Applying the “rational relationship” test, *Sakol v. Commissioner,* upheld section 83 of the Code which sets forth a statutory irrebuttable presumption. The court found that economic standards in the form of irrebuttable presumptions will be upheld where there is a rational relationship between the criteria set forth and a legitimate purpose for such standards.100

This rational relationship test, though, should not be applied in cases involving fundamental rights, because the inquiry here is whether the presumption established by a particular standard is universally true in fact and whether a reasonable alternative means exists to make the critical determination.101 Since private schools are both secular and religious, the first amendment fundamental right of the free exercise of religion is involved. Thus, if an irrebuttable presumption is involved in the Revenue

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81 285 U.S. 312 (1932).
82 Id. at 325.
86 574 F.2d at 698.
Procedures, then a two-pronged test must be applied. For private secular schools the proper test is the "rational relationship" test and for private religious schools it is the "universally true" test. In the Revenue Procedure, the Internal Revenue Service has not made such a distinction.

**CONGRESSIONALLY PROPOSED ALTERNATIVES TO THE PROPOSED IRS REVENUE PROCEDURE**

The materials which have been introduced into the Ninety-sixth Congress regarding the Proposed Revenue Procedure fall into three categories:

1. Resolutions expressing the sense of Congress.
2. Bills to prohibit the final issuance of the proposed revenue procedures.

Concurrent Resolutions expressing the sense of the Congress have been introduced by Congressmen Guyer, Satterfield, and Evans.

The resolutions of Congressmen Guyer and Satterfield advocate that the Revenue Procedure not be adopted since the purpose of tax legislation and regulation is to raise revenue, not to coerce certain classes of individuals toward government ends. According to the resolutions, to do so would violate freedom of choice for private groups and individuals since no rational nexus exists between the IRS function to collect taxes and the procedures.

Congressman Evans would seek to express the sense of Congress that the proposed procedures should not be adopted since they are an usurpation of Congressional authority. According to this resolution, Congress is the only constitutionally mandated authority to deal in this area and it has already expressed itself by exempting from taxation certain organizations operating exclusively for education purposes.

Bills to prohibit final issuance of the revenue procedures have been introduced by Congressmen McDonald, Evans, Quillen, St. Germain, Crane, Hammerschmidt, and Dickinson. The bills of Congressmen McDonald, Evans, Quillen, and St. Germain would prohibit the Secretary of the Treasury from issuing, in final or proposed form, the proposed guidelines, or issuing any regulation, revenue procedure, revenue ruling, or other guidelines setting forth rules similar to the proposed guidelines.

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If these bills are enacted, a conflict would occur when the suits which are currently pending against the IRS are decided. Pursuant to the *Green* case, these suits will most likely compel the IRS to take actions to enforce the non-discrimination rule applicable to private schools. The bills would not effect Revenue Procedure 75-50 which established criteria by which a school is granted or denied tax-exempt status.

The bills introduced by Congressmen Crane, Hammerschmidt, and Dickinson, like the other bills, would prohibit the Secretary of the Treasury from issuing the proposed Revenue Procedure or similar measures in final form. The distinction is that these bills would be for a limited period of time, until December 31, 1980. The reason for the limited period of effectiveness is to give Congress the time to consider whether it wishes to review in depth the tax status of private schools.

The effect of these bills would be the same for those previously discussed except that the likelihood of a judicial-congressional conflict would be reduced since the proscription against IRS publication of the Revenue Procedure would lapse prior to the final implementation of any judicial orders in the pending suits against the IRS.

Bills to amend Section 501 of the IRS Code have been introduced by Congressmen Dornan and Chappell. House Resolution 1002, introduced by Congressman Dornan, would amend Section 501(c)(3) of the IRS Code to legislatively provide that an exemption from taxation and a deduction for contributions made to organizations would not be construed as a provision of federal financial assistance. The intent of the bill is to remove the granting of tax exemptions and deductions from consideration as an offense to federal public policy.

This bill would conflict with Section 601 of the Civil Rights Act of 1964, which sets forth a federal public policy against support for racial segregation in private or public schools:

> No person in the United States shall on the grounds of race, color, or national origin, be excluded from participation in, be denied the benefits of, or be subjected to discrimination under any program or activity receiving Federal financial assistance.

Again, this bill conflicts with *Green v. Connally*, which held that tax exemptions and deductions to educational institutions were forms of federal benefits or indirect aid. The court stated that such aid is barred by section 601 of the Civil Rights Act and implied that it may also offend the Constitution.

If the granting of such aid is unconstitutional, merely amending the IRS Code would not be sufficient to relinquish the requirement of the

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revocation of tax exemption and deductions to discriminatory schools. If, in the suits pending against the IRS, the courts hold, on a constitutional basis, that exemptions and deductions for contributions constitute impermissible federal financial aid to discriminatory schools, the IRS may still be compelled to deny such exemptions and deductions. If the courts consider the issue to be a question of fact rather than law, the legislation would be outside the legislative authority of Congress. House Resolution 1002 would apply the amendment retroactively to all organizations under section 501(c), not just educational institutions.

Finally, the bill introduced by Congressman Chappell would amend section 501(c)(3) of the IRS Code to prohibit the IRS from terminating the exempt status of any institution organized for educational purposes solely because such school has a racially discriminatory policy unless the school has been adjudicated racially discriminatory in a federal or state court. Following the passage of this bill, the IRS could no longer terminate a school's tax-exempt status on the grounds of racial discrimination until a party with standing raised and litigated successfully whether a school was racially discriminatory. By means of this procedure, the burden of proof would shift from the educational institution to the plaintiff in an adversary proceeding which involved a justiciable controversy.

Parties with standing in a suit charging racial discrimination would include a student denied admission, the parents of such a student, and taxpayers in the community where the school is located. Since the statute requires the IRS to grant exemption to discriminatory schools if they otherwise qualify, the IRS would not be a party-in-interest for standing purposes.

In *Green*, the court held that the Internal Revenue Code required the "denial of tax exempt status and deductibility of contributions to private schools practicing racial discrimination." If this ruling involved a constitutional issue, the proposed amendment to the Internal Revenue Code would not be allowed. If, however, it was not a constitutionally-based issue, then the proposed amendment to the Code can stand. The *Green* court implied constitutional underpinnings were involved in its decision, but it was not explicitly stated.

In effect, then, the bill would require the IRS to continue the tax-exempt status of a school until an adjudication would be reached in a subsequent or non-administrative forum. However, the bill would not ban the IRS from denying an application for exemption to a racially discriminatory private school not already exempt.

Certainly Congressman Chappell's H.R. 96 is the most popular of the many bills which have been introduced. To date, it has been co-sponsored by eighty-six Congressmen from thirty-three states. In support of his bill, Mr. Chappell has asserted that it would focus on the schools which have given a probable cause to suspect discrimination rather than place a blan-
ket accusation on all schools founded or expanded during a particular period of time. Further, in a courtroom adjudication, an accurate description of the facts could be more easily attained than in an agency proceeding. The Chappell bill thus strives to balance a concern for the policy considerations expressed in *Green v. Connally* and a need for fairness towards all educational institutions falling within the ambit of the Revenue Procedure.

**CONCLUSION**

Since 1971, the Internal Revenue Service has been under an injunction to insure that tax-exempt status is not accorded to racially discriminatory private schools. Implementation of the mandate has become the most controversial endeavor the Service has ever undertaken. The greatest difficulty has arisen from the Service’s impatience with the courts’ adjudications of racial discrimination in the schools. Instead of relying upon judicial procedure it has proposed standards which would shift the burden of proof to the schools to prove administratively that they are not racially discriminatory.

Such regulation of private religious schools brings to the forefront difficult first amendment problems. While *Green v. Connally* held that the fundamental right to attend a private school did not imply a right to financial support, it did not rule whether tax exemption was a method of support. While *Goldsboro* stated that there is a legitimate secular purpose for denying tax exemption, *Bob Jones* held that first amendment rights are stronger than the government’s compelling interest to penalize discrimination. As a result, the judicial basis for the removal of tax-exempt status from discriminatory religious schools has not been firmly established.

Furthermore, another area of concern is the injury which the IRS could do to private religious education if the procedures it has proposed were used improvidently. While the argument can be made that the courts are available for redress, this is costly and time consuming and in many instances would mean the elimination of the school involved.

Certainly the concept behind the proposed guidelines is mandated by judicial action. If its application approaches government interference with first amendment-protected areas, however, then this whole area of the law should be re-examined with a view towards proper balancing of fundamental religious rights against the traditional policy against discrimination.

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18 Statement of Congressman William Chappell, Jr., before the Oversight Subcommittee of the House Ways and Means Committee (Feb. 28, 1979).