[JOINT COMMITTEE PRINT]

DESCRIPTION OF S. 103 AND S. 449

RELATING TO

TAX-EXEMPT STATUS

OF

PRIVATE SCHOOLS

SCHEDULED FOR A HEARING

BY THE

SUBCOMMITTEE ON TAXATION AND DEBT MANAGEMENT GENERALLY

OF THE

COMMITTEE ON FINANCE

ON APRIL 27, 1979

PREPARED FOR THE USE OF THE

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CONTENTS

I. INTRODUCTION

The Subcommittee on Taxation and Debt Management Generally of the Senate Committee on Finance has scheduled a hearing on April 27, 1979, on the tax-exempt status of private schools.

This pamphlet has been prepared by the staff of the Joint Committee on Taxation to provide background information in connection with the hearings. The pamphlet includes a description of the revised Revenue Procedure proposed by the Internal Revenue Service for determining whether certain private schools discriminate racially and, therefore, are ineligible for tax-exempt status. In addition, related legislative proposals and issues presented by both the proposed IRS guidelines and the legislation are outlined.

II. SUMMARY

Tax-exempt schools

The Internal Revenue Code provides tax-exempt status under section 501(c)(3) for organizations which are "organized and operated exclusively for religious, charitable, . . . or educational purposes." Exempt organizations are entitled to receive contributions which are deductible by their donors under section 170. Both the Internal Revenue Service and the Federal courts have required that schools be racially nondiscriminatory in order to qualify as tax-exempt organizations under section 501(c)(3) and as charitable donees under section 170(b).

In 1971, a 3-judge Federal district court panel issued a permanent injunction against the Internal Revenue Service requiring it to deny tax exemptions to private schools which discriminate racially with respect to students.[1] Subsequently, the Internal Revenue Service's procedures were challenged by the *Green* plaintiffs as inadequate for determining whether private schools discriminate racially and, thus, inadequate for fulfilling the injunction's requirements. The IRS itself decided that existing procedures were insufficient and that more effective ones were necessary.

Proposed revenue procedure

On February 9, 1979, the Internal Revenue Service issued, in proposed from, a Revenue Procedure containing guidelines for determining whether certain private schools discriminate racially and therefore are ineligible for tax-exempt status.[2] The procedure would apply to two categories of private elementary and secondary schools. The first group consists of adjudicated schools, which have been found to be racially discriminatory by a Federal or State court or by a Federal or State administrative agency. The second category contains reviewable schools. A reviewable school generally is a school whose formation or substantial expansion was related to public school desegregation in the community and which lacks significant minority student enrollment. The proposed guidelines would require that determinations about whether schools have racially nondiscriminatory policies with respect to students be based on all applicable facts and circumstances. An administrative "safe harbor" would be established so that schools whose minority enrollment is 20 percent (or more) of the percentage of minority school age population in the community ordinarily would not be reviewable. The guidelines also would provide a non-exclusive list of factors tending to show whether a school's formation or expansion was related to public school de-

[1] *Green* v. *Connally*, 330 F. Supp. 1150 (D.D.C. 1971), *aff'd per curiam sub nom., Coit* v. *Green*, 404 U.S. 997 (1971).

[2] This proposed procedure is a revision of a proposal published in the Federal Register on August 22, 1978.

segregation, as well as whether a reviewable school should be tax-exempt because it has made a good faith effort to attract minority students. The guidelines set forth procedures for handling revocations of exempt status, new applications for tax-exemption, and IRS National Office review of adverse determinations.

Legislative proposals

Several legislative proposals have been introduced in response to the IRS guidelines on tax-exempt schools. One bill (S. 103) would bar implementation of the proposed procedure, as well as any similar regulations, rulings, or guidelines. Another bill (S. 449) would amend section 501 with a new statutory provision finding that tax-exempt status under section 501(c)(3) and the deductibility of contributions to a section 501(c)(3) organization, such as a private school, shall not be construed as the provision of Federal assistance.

Issues

In addition to questions of administrative authority and feasibility, the proposed guidelines and the legislation introduced in their wake involve issues of Constitutional significance. Because many private schools are religious or church-affiliated, First Amendment issues arising under the Free Exercise and Establishment clauses confront the constitutional guarantees of racial equality. Because the guidelines were developed in the context of a Federal court injunction, the doctrine of the separation of powers under the Constitution also may be relevant.

III. BACKGROUND

A. Requirements for Tax Exemption

Section 501(c)(3) of the Internal Revenue Code provides for the exemption from Federal income tax of organizations "organized and operated exclusively for religious, charitable * * * or educational purposes." A primary or secondary school which has a regularly scheduled curriculum, a regular faculty, and a regularly enrolled body of students in attendance at a place where the educational activities are regularly carried on may qualify as a tax-exempt educational organization, if it otherwise meets the requirements of section 501(c)(3) (Treas. Reg. sec. 1.501(c)(3)–1(d)(3)(ii)).

Under the common law, the term "charity" encompasses all three of the major categories identified separately under section 501(c)(3) as religious, charitable, and educational. Both the courts and the Internal Revenue Service have determined that the statutory requirement of being organized and operated exclusively for religious, charitable, or educational purposes was intended to express the basic common law concept of charity. Therefore, a school claiming a right to the benefits provided by section 501(c)(3), as being organized and operated exclusively for educational purposes, must be a common law charity in order to qualify for exemption under that section.

Section 170 allows an income tax deduction for a charitable contribution, as defined in section 170(c), if payment is made within the taxable year. Under section 170(c), the term "charitable contribution" includes a contribution or gift to, or for the use of, an organization which is organized and operated exclusively for educational purposes. Thus, a private school which is exempt from tax under section 501(c)(3) of the Code is entitled to receive contributions which are deductible by their donors. However, section 170 applies only to contributions or transfers to organizations whose purposes are charitable in the generally accepted legal sense or to contributions for purposes that are charitable in the generally accepted legal sense.[1]

An organization seeking recognition of exempt status under section 501 is required to file an application with the District Director of Internal Revenue for the district where the principal place of business or principal office of the organization is located. A ruling or determination letter will be issued to an organization by the Internal Revenue Service if the organization's application and supporting documents establish that it meets the particular requirements of the section under which exemption is claimed. Exempt status will be recognized in advance of an organization's operations if proposed opera-

[1] Rev. Rul. 67–235, 1967–72 C.B. 113. The same definition of charitable also applies for purposes of the deduction allowed in determining Federal estate and gift taxes (secs. 2055, 2106(a)(2) and 2522).

tions can be described in sufficient detail to permit a conclusion that the organization will meet the particular requirements of the section under which exemption is claimed. In order to qualify for exemption, the organization is required to describe fully the activites in which it expects to engage, including the standards, criteria, procedures, or other means adopted or planned for carrying out the activities; the anticipated source of receipts; and the nature of contemplated expenditures.[2]

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[2] See Rev. Proc. 72–4, 1972–1 C.B. 706.

B. Court Challenges to Exempt Status of Private Schools

Racial discrimination in public education was held to be illegal and contrary to public policy in the Supreme Court decision of *Brown* v. *Board of Education*, 347 U.S. 483 (1954). Shortly after the decision in *Brown*, there were suggestions for the creation of private school systems to take the place of public school systems, which some States had threatened to abolish rather than desegregate. Efforts to establish private schools (so-called "segregation academies") in opposition to public school desegregation began in the early and mid-1960's, and were an integral part of the "massive resistance" legislation enacted by some States.

In 1970, Negro parents of school children attending public schools in Mississippi brought a class action to enjoin United States Treasury officials from according tax-exempt status from allowing deductions for and contributions to private schools in Mississippi discriminating against black students. In *Green* v. *Connally*, 330 F. Supp. 1150 (D. D.C. 1971), *aff'd per curiam sub nom.*, *Coit* v. *Green*, 404 U.S. 997 (1971), the court held that racially discriminatory private schools are not entitled to the Federal tax exemption provided for educational institutions and that persons making gifts to such schools are not entitled to the deductions provided in the case of gifts to educational institutions. The court placed the IRS under a permanent injunction to deny tax exemption to private schools in Mississippi that practice racial discrimination with respect to students, and ordered the IRS to implement its decision by requiring such schools to adopt and publish a nondiscriminatory policy and to provide certain statistical and other information to enable the IRS to determine if the schools are racially discriminatory.

While the injunction granted in *Green* applied only to Mississippi private schools, the court stated that the "the underlying principle is broader, and is applicable to schools outside Mississippi with the same or similar badge of doubt." [1]

Efforts by some States to provide State support to so-called "segregation academies" continued until recent years. The United States Department of Justice has been involved in extensive litigation to enjoin such State support.[2] As recently as 1973, the United States Supreme Court, in *Norwood* v. *Harrison*, 413 U.S. 455 (1973), struck down a Mississippi law to the extent that it provided for textbooks and transportation to students attending private, racially discriminatory schools. On remand in *Norwood*, 382 F. Supp 921 (N.D. Miss., 1974), the district court imposed a certification process to determine which private schools were racially discriminatory and, therefore, ineligible for State textbooks and transportation aid. The court stated that a

[1] 330 F. Supp. at 1174.

[2] See, e.g., *Graham and United States* v. *Evangeline Parish School Board*, 484 F. 2d 649 (C.A. 5, 1973); *United States* v. *Tunica County School District*, 323 F. Supp. 1019 (N.D. Miss.) *aff'd* 440 F. 2d 377 (C.A. 5, 1971); *United States* v. *Mississippi*, 499 F. 2d 425 (C.A. 5, 1974).

prima facie case of discrimination arises from proof "that the school's existence began close upon the heels of the massive desegregation of public schools within its locale, and that no blacks are or have been in attendance as students and none are or have ever been employed as teacher or administrator at the private school." [3]

In *Prince Edward School Foundation* v. *Commissioner*, Civil Action No. 78–1103 (D.C. D.C.), a declaratory judgment action decided on April 18, 1979, a Federal district court held that a nonprofit, private elementary and secondary school failed to meet its burden of establishing its qualification for tax-exempt status under section 501(c)(3). The court relied on the *Green* decision that racially discriminatory private schools are not entitled to the favorable tax treatment provided to section 501(c)(3) organizations. The court ruled that the school did not establish that its admissions policy was racially nondiscriminatory and stated that the Internal Revenue Service acted properly in revoking the school's exempt status. The court noted that the facts and circumstances surrounding the school's establishment supported the inference that the school followed a racially discriminatory admissions policy, notwithstanding the fact that the school never received an application from, and thus never denied admission to, a black student.

In *Brumfield and United States* v. *Dodd*, 425 F. Supp. 528 (E.D. La., 1976), a State program for textbook and transportation aid similar to the one considered in *Norwood* was enjoined and a similar certification process was imposed.

In 1976, the Supreme Court held, in *Runyon* v. *McCrary*, 427 U.S. 160 (1976), a case involving a proprietary, nonsectarian school which denied admission to black students, that the 1866 Civil Rights Act made it illegal for a school to deny admission to black students. This decision is applicable to a school without regard to whether it receives any Federal or State aid, and thus broadens the public policy against racial discrimination in private schools.

With regard to private religious schools, a recent district court decision, *Goldsboro Christian Schools, Inc.* v. *United States*, 436 F. Supp. 1314 (E.D.N.C. 1977), held that a private school is not entitled to tax exemption notwithstanding the religious belief on which its racially discriminatory admissions policy rests. The court in that case stated:

"There is a legitimate secular purpose for denying tax exempt status to schools generally maintaining a racially discriminatory admissions

[3] 382 F. Supp. at 924–5. The *Norwood* decision also provides examples of evidence which a school may offer to rebut an inference of discrimination:

> "School officials may, therefore, overcome a prima facie case against their school by proof of affirmative steps instituted by the school to insure the availability of all of its programs to blacks who may choose to participate. Illustrative steps of this type would certainly include proof of active and vigorous recruitment programs to secure black students or teachers, including student grants-in-aid, proof of continued, meaningful public advertisements stressing the school's open admissions policy, proof of communication to black groups and black leaders within the community of the school's nondiscriminatory practices, and similar evidence calculated to convince one that the doors of the private school are indeed open to students of both the black and white races upon the same standards of admission." 382 F. Supp. at 926.

policy. Moreover, the general across-the-board denial of tax benefits to such schools is essentially neutral, in that its principal or primary effect cannot be viewed as either enhancing or inhibiting religion. Finally, the policy patently avoids excessive governmental entanglement with and, in fact, prevents indirect government aid to, religion." [4]

On the other hand, in *Bob Jones University* v. *United States*, Civ. No. 76–775 (D.S.C., filed Dec. 26, 1978), a district court held improper the revocation by the IRS of the tax-exempt status of a religious university allegedly practicing racial discrimination. The discrimination issue involved in that case was whether the university's policy of not admitting racially mixed couples rendered it ineligible for tax exemption. The government is appealing this decision.

[4] 436 F. Supp. at 1320.

C. Internal Revenue Service Response to *Green* v. *Connally*

1. Prior rulings and procedures

Pre-1970

The Internal Revenue Service suspended the issuance of rulings to private schools in 1965 in order to consider the effect of racial discrimination on the tax-exempt status of private schools. In 1967, the IRS announced its position that racially discriminatory private schools, which were receiving State aid, were not entitled to tax-exempt status.[1]

Prior to 1970, the position of the IRS was to recognize the tax-exempt status of racially discriminatory private schools that did not receive State aid. However, this policy was challenged in *Green* v. *Connally*, which held that racially discriminatory private schools are not entitled to tax exemption under section 501(c)(3). During the pendency of litigation in *Green* v. *Connally*, the IRS announced the position that racially discriminatory private schools are not entitled to tax exemption (whether or not receiving State aid).[2]

1970–1971

Since 1970 and the *Green* decision, the Internal Revenue Service has taken a number of steps to implement the nondiscrimination requirement. In 1971, the IRS published Revenue Ruling 71–447, 1971–2 C.B. 230, which explained the nondiscrimination requirement. That ruling held that a private school which does not have a racially nondiscriminatory policy as to students is not "charitable" within the common law concepts reflected in sections 170 and 501(c)(3), and in other relevant Federal statutes, and, accordingly, does not qualify as an organization exempt from Federal income tax. The term "racially nondiscriminatory policy as to students" was defined to mean that the school admits the students of any race to all the rights, privileges, programs, and activities generally accorded or made available to students at that school and that the school does not discriminate on the basis of race in administration of its educational policies, admissions policies, scholarship and loan programs, and athletic and other school-administered programs.

1972 Revenue Procedure

In 1972, the Internal Revenue Service published Revenue Procedure 72–54, 1972–2 C.B. 834, which set forth guidelines for determining whether certain private schools which have rulings recognizing their tax-exempt status, or which are applying for recognition of exemption under section 501(c)(3), have adequately publicized their racially nondiscriminatory policies as to students. The Revenue Procedure provided that a showing that the school does in fact have a meaningful number of students from racial minorities enrolled is evidentiary of

[1] IRS News Release, August 2, 1967.
[2] IRS News Release, July 10, 1970.

a nondiscriminatory admissions policy. However, the 1972 procedure stated such a showing will not in itself be conclusive that the school has a racially nondiscriminatory policy as to students. A school that did not establish that it operated under a bona fide racially nondiscriminatory policy as to students was required, in order to qualify for exemption, to take affirmative steps to demonstrate that it would so operate in the future. The school was required to show that a racially nondiscriminatory policy as to students had been adopted; that the policy had been made known to all racial segments of the community served by the school; and that the policy was being administered in good faith.

Revenue Procedure 72–54 provided several examples of methods by which publication of a school's nondiscriminatory policy could be made. The procedure did not require the use of any particular method, so long as the method chosen effectively made the policy known to all racial segments of the community served by the school. Examples of methods that the IRS would consider as meeting the publication requirement included the publication by a school of notice of its racially nondiscriminatory policy in a newspaper of general circulation serving all racial segments of the locality from which the school's student body is drawn: the use of broadcast media by a school to publicize its racially nondiscriminatory policy; the publication of a school's nondiscriminatory policy through its school brochures and catalogues; and communication by the school of its nondiscriminatory policy to leaders of racial minorities in such a way that they, in turn, would make the policy known to other members of their race.

1975 Revenue Procedure

In 1975, the U.S. Commission on Civil Rights criticized the absence of specific Internal Revenue Service guidelines to identify schools which should be examined and to determine whether schools are discriminatory. The Internal Revenue Service subsequently published Revenue Procedure 75–50, 1975–2 C.B. 587, which set forth guidelines and recordkeeping requirements for determining whether private schools applying for recognition of exemption under section 501(c)(3), or presently recognized as exempt from tax, have racially nondiscriminatory policies.

In general, the guidelines in Revenue Procedure 75–50 are as follows:

(1) A school must include a statement in its charter, bylaws, or other governing instrument, or in a resolution of its governing body, that it has a racially nondiscriminatory policy as to students and, therefore, does not discriminate against applicants and students on the basis of race, color, or national or ethnic origin.

(2) Every school must include a statement of its racially nondiscriminatory policy as to students in all its brochures and catelogues dealing with student admissions, programs, and scholarships.

(3) The school must make its racially nondiscriminatory policy known to all segments of the general community served by the school.

(4) A school must be able to show that all of its programs and facilities are operated in a racially nondiscriminatory manner.

(5) As a general rule, all scholarships or other comparable benefits procurable for use at any given school must be offered on a racially nondiscriminatory basis. Their availability on this basis must be known throughout the general community being served by the school and should be referred to in the publicity necessary to satisfy the third requirement in order for that school to be considered racially nondiscriminatory as to students.

The procedure also requires an individual authorized to act officially on behalf of a school which claims to be racially nondiscriminatory as to students to certify annually, under penalties of perjury, on a form issued by the IRS, that to the best of his knowledge and belief the school has satisfied the requirements listed in the procedure.

The 1975 Revenue Procedure further provides that the existence of a racially discriminatory policy with respect to employment of faculty and administrative staff is indicative of a racially discriminatory policy as to students. Conversely, the absence of racial discrimination in employment of faculty and administrative staff is indicative of a racially nondiscriminatory policy as to students.

Failure to comply with the guidelines set forth in Revenue Procedure 75–50 ordinarily will result in the proposed revocation of the tax-exempt status of a school.

1975 Revenue Ruling

In 1975, the Internal Revenue Service also published a Revenue Ruling clarifying the Service's position that private schools operated by churches, like other private schools, may not retain tax-exempt status if they are racially discriminatory.[3] Revenue Ruling 75–231, 1975–1 C.B. 158, held that church-related and church-operated organizations conducting schools with policies of refusing to accept children from certain racial and ethnic groups will not be recognized as tax-exempt charities under sections 170 and 501(c)(3). The IRS found that there was no basis for treating such schools differently from other private schools not affiliated with a church. The ruling further held that the disqualification of the tax-exempt status of a church-related school, organized as a separate entity under the auspices of a church, will not affect the tax-exempt status of the organization qualifying as a church. The disqualification of the tax-exempt status of a church-related school, which is not separately incorporated and is directly supervised and controlled by a church that requires the school to maintain a racially discriminatory policy as to students, will render the organization, as a whole, noncharitable.

2. Reopening of *Green* v. *Connally* and issuance of proposed Revenue Procedure

In 1976, the plaintiffs in the *Green* case reopened that suit, asserting that the Internal Revenue Service was not complying with the court's continuing injunction that Mississippi private schools which are racially discriminatory be denied exemption from Federal income tax.[4] In addition, a companion suit was filed, asserting that the Service's

[3] This position is in accord with a later district court decision. See, *Goldsboro Christian Schools, Inc.* v. *United States*, 436 F. Supp. 1314, (E.D.N.C. 1976).

[4] *Green* v. *Blumenthal*, No. 1355–69 (D.D.C.).

enforcement of the nondiscrimination requirement, on a nationwide basis, has been ineffective.[5] These two cases are now pending.

This recent litigation prompted the Internal Revenue Service to review the adequacy of its policies and procedures relating to the tax-exempt status of private schools. The Internal Revenue Service concluded that its procedures have been ineffective in identifying schools which, in actual operation, discriminate against minority students, even though those schools may profess an open enrollment policy and may comply with the annual publication requirements of Revenue Procedure 75–50.

The Internal Revenue Service concluded that, as a result of its current procedures, the tax exemption of a school which adopts a nondiscriminatory policy in its governing instrument, and publishes this policy annually, is likely to remain undisturbed unless some overt act of discrimination is brought to the Service's attention.

After reviewing the relevant court decisions, the standards used in those decisions, and its existing guidelines, the Internal Revenue Service concluded that more specific guidelines were needed in order to focus on certain schools' actual operations, for the purpose of determining if their actual practices conform to their asserted policies. The Internal Revenue Service developed and published, in proposed form, new guidelines for use in reviewing a private school's racial policy on August 21, 1978. These proposed guidelines were revised in 1979. The revised version is discussed in the following part.

[5] *Wright* v. *Blumenthal*, No. 76–1426 (D.D.C.).

IV. IRS PROPOSED REVENUE PROCEDURE

A. What is a Revenue Procedure?

The Internal Revenue Service's Revenue Procedure program is closely related to its rulings program. Prior to 1955, it was IRS practice to issue I.R.-Mimeographs and I.R.-Circulars, as well as similar documents, which contained information on internal management practices affecting taxpayers. In order to consolidate this practice, and to bring together all announcements relating to internal procedures, the IRS created the Revenue Procedure series.

In Revenue Procedure 55–1, 1955–2 C.B. 897, the Internal Revenue Service announced its policy to publish all statements of practice and procedure issued for internal use, which affect rights and duties of taxpayers or other members of the public under the Internal Revenue Code and related statutes, in the form of Revenue Procedures in the Internal Revenue Bulletin.

Revenue Procedures also are used to inform taxpayers of instructions given to IRS personnel for use in audit. In this context, Revenue Procedures are used to promulgate rules of convenience, that is, rules which set guidelines enabling the IRS to simplify audits in many areas.

B. Chronology of Proposed Revenue Procedure

1. Original issuance

On August 21, 1978, the Internal Revenue Service announced prospective publication of a "Proposed Revenue Procedure on Private Tax Exempt Schools," designed to revise administrative guidelines for determining whether a private school operates in a racially nondiscriminatory manner (I.R. News Release 2027). The procedure dealt primarily with two classes of private elementary and secondary schools: (1) schools adjudicated to be discriminatory, and (2) schools which were formed or substantially expanded at the time of public school desegregation and which have little or no minority enrollment. Under the proposed procedure, these two classes of schools would have been reviewed administratively and would have been required to make special showings to rebut indications of racial discrimination.

The procedure was published in proposed form because the IRS recognized the difficult nature of its undertaking and its inability to predict the proposed procedure's impact in varying circumstances. For this reason, the IRS solicited public comment about adjustments and modifications which might be appropriate.

2. IRS hearings and issuance of revised proposed procedure

The Internal Revenue Service received numerous comments on the proposed procedure and conducted public hearings on it on December 5, 6, 7, and 8, 1978. After reviewing the written and oral comments, the IRS modified the proposed revenue procedure and issued a revised proposed revenue procedure on February 9, 1979 (I.R. News Release 2091).

The revised procedure is more flexible than the original and differs from it in several respects. For example, the revised procedure does not apply to schools which are not alternatives to desegregated public elementary and secondary schools. It is inapplicable to colleges, universities, nursery schools, or schools for the handicapped or emotionally disturbed. The revised procedure also gives greater consideration to each school's particular circumstances than did the original version, in order to avoid administrative denials of exemption to schools that are not, in fact, racially discriminatory.

C. Explanation of Proposed Revenue Procedure

1. Purpose

The proposed Revenue Procedure, as revised by the IRS, sets forth guidelines for the Internal Revenue Service to apply in determining whether certain private schools have racially discriminatory policies as to students and, therefore, are not qualified for tax exemption under section 501(c)(3).

The Internal Revenue Service believes that a school's formation or expansion at the time of public school desegregation in the community may cast doubt on the existence of a bona fide racially nondiscriminatory policy. In such situations, the mere assertion and publication of a nondiscriminatory policy may be insufficient to demonstrate bona fide nondiscriminatory operation. It is with such situations that the proposed procedure is primarily concerned. Relying on *Norwood* v. *Harrison* and *Brumfield* v. *Dodd*, the IRS published the proposed procedure in the belief that a private school's formation or expansion at the time of public school desegregation in the community makes it appropriate to examine whether actions have been taken by the school to overcome the indications that it was established to foster racial segregation and that it discriminates against minorities.

The proposed procedure sets forth guidelines to identify certain private elementary and secondary schools that are, in fact, racially discriminatory even though they may claim to have a racially nondiscriminatory policy as to students.

2. Coverage

The proposed Revenue Procedure applies to private elementary and secondary schools, other than schools organized and operated solely for the education of the handicapped or the emotionally disturbed. For example, the procedure would apply to church-related and church-operated elementary and secondary schools, but would not apply to colleges and universities, pre-schools, nursery schools, or schools for the blind or the deaf.[1]

3. Categories of affected schools

The proposed Revenue Procedure is intended to apply to two categories of private schools: (1) schools adjudicated to be discriminatory and (2) reviewable schools.

A school "adjudicated to be discriminatory" is defined as any school found to be racially discriminatory as to students by a final decision of a Federal or State court of competent jurisdiction; by final agency action of a Federal administrative agency in accordance with the pro-

[1] The guidelines contained in the original version of the proposed procedure, while generally applicable only to private elementary and secondary schools, would have been applied, in appropriate cases, to other types of schools. For example, the IRS indicated that those guidelines could have been applicable to a college or university that was adjudicated to be discriminatory.

cedures of the Administrative Procedure Act, 5 U.S.C. 551, *et. seq.*; or by final agency action of a State administrative agency following a proceeding in which the school was a party or otherwise had the opportunity for a hearing and an opportunity to submit evidence. Final decisions and actions mean no further administrative or judicial appeal can be taken.[2]

A "reviewable school" is defined as a school (1) which was formed or expanded at the time of public school desegregation in the community served by the school; (2) which does not have a significant minority [3] student enrollment; and (3) whose creation or substantial expansion was related, in fact, to public school desegregation in the community. Under the proposed Revenue Procedure, a school would be treated as reviewable only when all three of the foregoing characteristics exist.[4]

"Community" served by the school is defined to mean the public school district within which the school is located, together with any other public school district from which the school enrolls a substantial percentage of its student body. As an objective factor, the IRS will consider 20 percent a substantial percentage of a school's student body. If a court desegregation order involves the mandatory assignment of students to or from any of such foregoing school districts, community includes all public school districts covered by the order, and the appropriate percentage of minority students will be determined with reference to all such districts.

Under the procedure, a school will be considered formed or substantially expanded at the time of public school desegregation in the community served by the school if the school's formation or expansion takes place during any calendar year any part of which falls within the period beginning one year before implementation of a public school desegregation plan in the community and ending three years after substantial implementation of such desegregation order or plan. On the other hand, the proposed guidelines provide that a school will not be considered to have substantially expanded during a particular calendar year, if the increase in the maximum number of students enrolled in the school at any time during that calendar year is 20 percent [5] or less of the maximum number of students enrolled in the school at any time during the immediately preceding calendar year. If the increase in enrollment is greater than 20 percent, the IRS

[2] The original version of the proposed procedure did not so state.

[3] "Minority" is defined as including Blacks, Hispanics, Asians, or Pacific Islanders, and American Indians or Alaskan Natives.

[4] The original version of the proposed Revenue Procedure generally would have classified a school formed or substantially expanded at the time of public school desegregation as "reviewable" if its percentage of minority enrollment was less than 20 percent of the percentage of school age minorities in the community. These schools would have been required to show, by the existence of at least four out of five specific factors, that their relatively low level of minority enrollment was not due to racially discriminatory policies. These factors were: (1) availability of, and granting of, scholarships or other financial assistance on a significant basis to minority students; (2) active and vigorous minority recruitment programs; (3) an increasing percentage of minority student enrollment; (4) employment of minority teachers or professional staff; and (5) other substantial evidence of good faith.

[5] The original version of the proposed procedure used the figure of 10 percent.

is required to make a determination whether the expansion is related, in fact, to public school desegregation before treating the school as reviewable.

The proposed Revenue Procedure recognizes that the question of whether a particular school's minority enrollment is significant depends on all the relevant facts and circumstances. The procedure provides that consideration will be given to special circumstances that may limit a school's ability to attract minority students. As an example of a special circumstance, the procedure cites a school's emphasis on special programs or special curricula which by their nature are of interest only to identifiable groups that are not composed of a significant number of minority students, provided that such programs or curricula are not offered for the purpose of excluding minorities.

The procedure provides a "safe harbor" for private schools. The IRS will consider a school to have a significant minority enrollment, and therefore, not be reviewable, if the school's percentage of minority students is equal to 20 percent or more of the percentage of the minority school age population in the community served by the school.[6]

In addition, the proposed Revenue Procedure allows certain schools that are part of a system of commonly supervised schools to be considered in the context of the system as a whole. It provides that if a particular school that is part of a system of commonly supervised schools otherwise would be treated as not having significant minority school enrollment (*e.g.*, because it does not meet the 20 percent "safe harbor" test), it may nevertheless be considered to have a significant minority student enrollment if all of the following conditions are met: (1) taking into account all schools operated by the system within the community, the school system, in the aggregate, has significant minority student enrollment; (2) the schools within the community serve designated geographical areas, and the designations are based on considerations other than race; and (3) there is no evidence that the school system operates on a racially discriminatory basis, such as through the operation of a dual school system based on race.

The proposed Revenue Procedure indicates that, as a general rule, the formation or substantial expansion of a private school at the time of public school desegregation in the community ordinarily will be considered to be related in fact to public school desegregation. However, the IRS will consider evidence that a school's formation or substantial expansion was not related in fact to public school desegregation in the community and therefore, that the school is not a reviewable school. The procedure lists seven nonexclusive factors as indicative of the fact that a private school's formation or substantial expansion may not have been related in fact to public school desegregation:

> (1) The students to whom the opening or substantial expansion of the school is attributable are not to any significant extent drawn from the public school grades subject to desegregation in the community served by the school.

[6] The proposed Reveue Procedure contains the following example: if 50 percent of the school age population in the community is minority, and the school enrolls 200 students, the school would not be reviewable if it had at least 20 minority students. (20 percent × 50 percent=10 percent. 10 percent × 200 students=20 students.)

(2) The rate of expansion is not greater than the rate of expansion experienced by the school in years prior to the time of public school desegregation.

(3) The expansion is attributable to an increase in the school age population in the community.

(4) The expansion results from a merger of the school with another private school and neither of the schools is otherwise "reviewable."

(5) The expansion is attributable to a continuation of previous period expansion by adding grade levels as the school's enrollment in lower grades advances, and the school does not enroll in the newly added grades a significant number of new students from the public schools.

(6) The 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.

(7) At the time of formation or expansion, the school had some minority students, faculty, or board members.

On the other hand, the proposed Revenue Procedure cites the following seven nonexclusive factors as indicative of a private school's formation or substantial expansion being related in fact to public school desegregation in the community:

(1) The opening or substantial expansion of the school occurs in one or more of the same grades subject to public school desegregation.

(2) The students are drawn primarily from the public schools.

(3) The school occupies or utilizes former public school facilities made available to the school in the course of implementation of the public school desegregation plan.

(4) The school is a member of an organization which practices or advocates racial segregation in schools.

(5) The school, or its founders, officers, substantial contributors, or trustees, have engaged in efforts to oppose desegregation of the public schools.

(6) The school, in practice, limits enrollment to students from a geographic area (or areas) with few or no minorities, and this limitation coincides with a public school desegregation plan that involves exchanges of students between such area (or areas) and one or more other areas that have a substantial school age minority population.

(7) Non-minority faculty members added to the school's staff, at the time of its formation or substantial expansion, are drawn primarily from the public school system subject to desegregation.

4. Operative guidelines

The proposed Revenue Procedure provides that, notwithstanding a prior adjudication of racial discrimination as to students, a school that has been adjudicated to be racially discriminatory as to students will

be considered to be operated on a nondiscriminatory basis if the school can show that: (1) it currently has significant minority enrollment,[7] or (2) that it has undertaken actions or programs reasonably designed to attract minority students on a continuing basis. However, an adjudicated school ordinarily will not be considered to be operated on a racially nondiscriminatory basis unless the school has enrolled some minority students.

Likewise, the proposed procedure provides that, notwithstanding the fact that a school is found to be a reviewable school, the school will be considered to have a racially nondiscriminatory policy as to students if the school can show that it has undertaken actions or programs reasonably designed to attract minority students on a continuing basis.

In order to qualify for Federal income tax exemption, the actions or programs which a school undertakes to attract minority students must convey clearly to the affected minority community that, notwithstanding the circumstances of the school's formation or expansion and the absence of a significant number of minority students, the school, in fact, operates on a nondiscriminatory basis and minorities are welcome at the school. The proposed procedure recognizes that an adequate level of actions and programs may vary from school to school and depends on the circumstances of the school, including the level of minority school enrollment. The following factors are cited as examples of actions and programs that may contribute to attracting minority students on a continuing basis:

(1) Active and vigorous minority recruitment programs, such as extensive public advertisements in media designed to reach the minority community, specifically inviting minority applicants; communication to minority groups and minority leaders in the community, inviting minority applicants; personal contacts of prospective minority students; and participation in local, regional, or national programs designed to develop new sources of minority recruitment for the school.

(2) Publicized offers of tuition waivers, scholarships, or other financial assistance, with emphasis on their availability for minority students; or actual grants of such financial assistance to minority students.

(3) Employment of, or substantial efforts to recruit, minority teachers or other professional staff.

(4) Participation with integrated schools in sports, music, and other events or activities.

(5) Special minority-oriented curriculum or orientation programs.

(6) Minority members of the board or other governing body of the school.

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[7] A determination of whether a school has significant minority enrollment will depend on all relevant facts and circumstances. However, the "safe harbor" standards available for avoiding "reviewable" status also will apply to current enrollment of previously adjudicated schools. Thus, an adjudicated school will be considered operated on a nondiscriminatory basis if its minority student enrollment is 20 percent or more of the percentage of minority school age population in the community.

Under the proposed Revenue Procedure, the failure of a school's actions or programs, undertaken to attract minority students, to obtain some minority enrollment within a reasonable period of time will be a factor in determining whether such activities are adequate or are undertaken in good faith.

5. Other provisions

The proposed Revenue Procedure prescribes administrative actions and procedures for handling status reviews. The Internal Revenue Service will propose revocation of exemption for schools adjudicated to be discriminatory and for reviewable schools which do not meet the procedure's guidelines. However, in appropriate cases, the IRS will consider deferring the issuance of a final revocation notice to a school which does not meet the proposed guidelines. A school must request deferral of the revocation and must set forth actions already taken, and to be undertaken, in good faith which demonstrate a racially nondiscriminatory policy.

Favorable rulings or determinations will be issued to schools adjudicated to be discriminatory only if they currently have significant minority enrollment or have undertaken actions or programs reasonably designed to attract minority students. Reviewable schools which have commenced operation will receive favorable rulings or determinations only if they undertake actions or programs reasonably designed to attract minority students. If a school has no record of actual operations, a favorable ruling or determination will be issued only if the school's proposed operations can be described in sufficient detail to permit a determination that the school will not be classified as a reviewable school or, that if reviewable, it would meet the guidelines for actions designed to attract minority students.

6. National Office review

To assure correct and consistent application of the proposed Revenue Procedure, the IRS National Office will review all applications for exemption and all examinations of private elementary and secondary schools.

7. Effective date

In the case of schools adjudicated to be discriminatory, the proposed Revenue Procedure is intended to be effective as of the date of final publication. In the case of reviewable schools, it is intended to be effective for purposes of examinations on and after January 1, 1980.[8]

[8] In the case of reviewable schools whose applications for exemption are pending on the date of final publication and which do not meet the proposed guidelines, the procedure will be effective as of final publication; however, the IRS, if requested by such a school, will defer any action on its application for exemption until January 1, 1980, in order to give the school an opportunity to demonstrate its compliance with the guidelines.

V. DESCRIPTION OF BILLS

A. S. 103

(Senators Hatch, Byrd of Virginia, Garn, Goldwater, Hayakawa, Helms, Laxalt, McClure, Stevens, Thurmond, Tower, Armstrong, Humphrey, Lugar, Schweiker, and Warner)

This bill would prohibit the Internal Revenue Service from implementing its proposed Revenue Procedure for determining whether certain private schools claiming tax-exempt status operate in a racially discriminatory manner. The prohibition would apply to the final issuance of the original proposed guidelines published in the Federal Register of August 22, 1978, and to the issuance of any other proposed or final regulation, revenue procedure, revenue ruling, or other guidelines setting forth rules which are substantially similar to the rules in the February 22, 1978, procedure.

The effect of the bill would be to leave the examination of private schools for discriminatory operations to be conducted on a case-by- case basis in the usual IRS audit process or in the course of making determinations on applications for recognition of exempt status.

The prohibition would be effective for the period beginning on the date of enactment and ending on December 31, 1980.

B. S. 449

(Senators Hatch, Garn, Stevens, and Young)

This bill would amend section 501 (relating to exemption from tax on corporations, certain trusts, etc.) by adding to the statute a new rule of statutory construction to govern interpretation of subsection (c)(3) (relating to organizations organized and operated exclusively for religious, charitable, etc., purposes). The bill would provide that neither the grant of a tax exemption under section 501(c)(3) nor the allowance of a charitable contribution deduction to a section 501(c)(3) organization may be construed as the provision of Federal assistance. This rule of construction would govern regardless of any other statutory provision or any judicial decision.

The amendment made by the bill would apply to all taxable years.

VI. ISSUES

A. Standards for Exemption

1. Discrimination

A school must have a racially nondiscriminatory policy as to students in order to qualify as an organization exempt from Federal income tax.[1] The proposed Revenue Procedure sets forth guidelines which the Internal Revenue Service will apply in determining whether certain private schools have racially discriminatory policies as to students and therefore, are not qualified for tax exemption under section 501(c)(3). The guidelines are directed toward two categories of schools: (1) schools "adjudicated to be discriminatory" and (2) "reviewable schools."

Generally, there is little doubt that a school which has been adjudicated to be discriminatory by a Federal or State court of competent jurisdiction or proper Federal or State administrative agency will be considered racially discriminatory and will be denied Federal tax exemption. Because of this, some have argued that the proposed Revenue Procedure should apply only to schools adjudicated to be discriminatory, if it is to apply at all.

Those who oppose limiting the procedure to adjudicated schools note that if the classification of a school as an adjudicated school is intended to depend on adjudications of discrimination in nontax proceedings, the number of schools actually examined for discrimination will depend on nontax considerations and the number of adjudications may be largely a matter of chance. In addition, some believe that the proposed procedure does not go far enough because it limits court or agency findings of discrimination which trigger the loss of tax exemption to "final" court or agency decisions from which no further judicial or administrative appeal can be taken. A school might maintain its tax-exempt status for several years through the process of lengthy appeals. For example, almost nine years passed between the IRS's direct notification to the Prince Edward School Foundation about the nondiscriminatory requirements in 1970 and the district court decision in 1979 holding the school ineligible for tax-exempt status because of its racially discriminatory admissions policy.[2] On the other hand, requiring the finality of a court or agency decision before a school is classified as one "adjudicated to be discriminatory" provides a measure of certainty to that classification. It should be noted that schools claiming exemptions, not just the IRS, may seek adjudications. Under section 7428, a school is entitled to judicial review of any adverse IRS determination of exempt status. A school also may go to court if the IRS fails to act on any application for exemption within 270 days. Even if an adverse IRS determination is upheld, a contri-

[1] See, Revenue Rulings 71–447, 1971–2 C.B. 230 and 75–231, 1975–1 C.B. 158.

[2] *Prince Edward School Foundation* v. *Commissioner*, Civil Action No. 78–1103 (D.D.C.), April 18, 1979. This decision will not be final if plaintiffs appeal.

butor to the school generally may claim a charitable contribution deduction for contributions of up to $1,000 for the period between IRS publication of the notice of revocation and the final decision of the court.

The proposed Revenue Procedure defines a "reviewable school" as a school (1) which was formed or substantially expanded at the time of public school desegregation in the community served by the school, (2) which does not have significant minority student enrollment, and (3) whose creation or substantial expansion was related in fact to public school desegregation in the community.

Under the proposed procedure, a school will be considered formed or substantially expanded at the time of public school desegregation in the community served by the school if its formation or expansion takes place during any calendar year any part of which falls within the period beginning one year before implementation of a public school desegregation plan in the community and ending three years after substantial implementation of such desegregation order or plan.

A possible objection to this provision is that a private school might be exempt from the Revenue Procedure because implementation of a public school desegregation plan has been delayed in a particular community. On the other hand, a private school located in a community where a public school desegregation plan has not been delayed would not be exempt from the procedure, even assuming all other facts regarding the two schools are similar. If delay in the implementation of public school desegregation plans is a concern, the starting date of the review period could be changed to coincide with the date of the court order or the date of agreement to a voluntary plan of desegregation. Another problem may be the lack of guidelines for determining when "substantial implementation" of public school desegregation has occurred.

In order to be classified as a reviewable school, a school must be one that does not have a significant minority enrollment. In determining whether a school has significant minority enrollment, the IRS will give consideration to specific circumstances which limit a school's ability to attract minority students. However, some may be concerned that a near or total absence of minority students could never be regarded as significant minority enrollment, even with consideration being given to the effects of special programs and special curricula.

In some situations, it might be that no inference of racial discrimination should arise because of the existence of very small, or no, minority enrollment. On the other hand, some believe that the enrollment of very few, or no, minority students is indicative of an intent to discriminate.

The proposed procedure provides for a "safe harbor" so that a school will be considered to have a significant minority enrollment if it has minority students equaling, or exceeding, 20 percent of the percentage of the minority school age population in the community. Some are concerned that this is too liberal a test and would lead to "tokenism" in order to avoid the guidelines. Others contend that this test is too difficult for many private schools and that the percentage should be lower. Still others are concerned that fixing any percentage would lead to a quota system in the private schools and, thus, should be avoided.

The proposed procedure states that the formation or substantial expansion of a school at the time of public school desegregation in the community ordinarily will be considered to be related in fact to pub-

lic school desegregation. It then lists seven factors tending to indicate that the formation or substantial expansion of a school was not related to public school desegregation and seven factors tending to indicate that the formation or substantial expansion of a school was related to public school desegregation. Some have expressed concern that the fact a school was formed or substantially expanded at the time of public school desegregation in the community may be entirely fortuitous and should be given no weight whatsoever, while others consider that fact clearly indicative of an express intent to discriminate. In addition, concern has been expressed that the procedure is unclear with regard to whether it is the IRS or the school which has the responsibility for gathering the facts necessary to indicate that a school's formation or substantial expansion was not related to public scool desegregation.

Even though a private school may be determined, under the proposed guidelines, to be an adjudicated school or a reviewable school, that determination, in and of itself, does not mean that the tax-exempt status of a private school automatically will be revoked. The proposed procedure allows an adjudicated or reviewable school to avoid revocation of tax-exempt status if it can show that it has undertaken actions or instituted programs reasonably designed to attract minority students, and sets forth examples of such affirmative actions and programs. Some groups have challenged the propriety of some of these examples and have asked whether schools would be expected to undertake all, or most, of these efforts to demonstrate their good faith intentions. Some argue that failure to undertake certain of the designated actions and programs should not support a negative inference where, for example, a school is financially unable to offer scholarships or tuition aid or it would be impractical to expect a school to offer special minority-oriented curricula. On the other hand, others believe that the procedure's examples of affirmative actions and programs are the minimum necessary to establish a racially nondiscriminatory policy.

2. Differences in application of procedure—depending on when school was formed or expanded

Unless a private school has been adjudicated to be discriminatory, the proposed Revenue Procedure will apply only if a private school was formed or substantially expanded at the time of public school desegregation in the community. Some have expressed concern that private schools formed or substantially expanded at the time of public school desegregation in the community are unfairly singled out by the IRS for close scrutiny, while other private schools not so formed or expanded may escape the guidelines even if they have clearly discriminatory admissions' policies. Others believe that if a school has been formed or substantially expanded at the time of public school desegregation, that fact may be indicative of an intent to discriminate and that it is upon those schools that the IRS should focus its attention. Still others note that the time of a school's formation or substanital expansion may be entirely fortuitous and should have no bearing whatsoever in determining whether or not a school discriminates. Moreover, because the proposed guidelines focus on communities that have experienced desegregation, certain areas of the country may receive a disproportionate amount of IRS attention because desegregation has been implemented more formally or more fully in those areas.

B. Administrative and Regulatory Problems

1. Burden of proof

If a school is classified as one "adjudicated to be discriminatory" or "reviewable" under the proposed Revenue Procedure, it is required to show that it has undertaken actions or programs reasonably designed to attract minority students on a continuing basis. The procedure sets forth six examples of actions and programs that may contribute to attracting minority students. These actions and programs must convey to the minority community that the school is in fact operating on a nondiscriminatory basis.

Some believe that the standards set forth in the proposed Revenue Procedure establish an irrebutable presumption against certain schools and, therefore, violate the due process clause of the Fifth Amendment of the Constitution. They contend that the legal and administrative expense of proving a school to be nondiscriminatory would be an impossible burden in many cases and that the costly legal action necessary to prove a school's nondiscrimination could prove excessively expensive. Moreover, some argue that if a private school never has denied admission to a minority applicant, it should not have thrust upon it the burden of proving a racially nondiscriminatory policy.

On the other hand, some believe that the burden of proving that a private school is discriminatory has been placed almost entirely upon the IRS. They argue that, under the proposed procedure, the IRS must not only find an objective prima facie case in order to examine a school but also must find the absence of facts illustrative of the relation of the school's formation or expansion to public school desegregation and the presence of facts illustrative of that relation. Therefore, they think that no school will be reviewable until the IRS first proves conclusively that the school is discriminatory. They note that this is generally the reverse of the process by which the Federal courts determine discrimination.

2. Definitions

As discussed above (under VI. A. *Standards for Exemption*), some have expressed concern as to whether an agency or court decision should be "final" before a school is considered as one adjudicated to be discriminatory. Questions also have been raised as to whether the definition of reviewable schools is too narrow and what should constitute significant minority enrollment.

A definitional problem which has raised some concern is the meaning of the term "community" served by the school for purposes of determining whether a school has significant minority enrollment. For example, it is unclear how the procedure's definition of community would operate with respect to a school which enrolls students from across the nation. Such a school might not enroll 20 percent of its students from any particular school district, thus leading to confusion

in the determination of whether that school has significant minority enrollment. This objection might be addressed by providing that when a school does not enroll a substantial percentage of students from any one school district, the term "community" includes all States from which the school enrolls a substantial percentage of its students.

Another problem raised with respect to the definition of community is that two private schools each located in a different public school district with a different racial composition but competing with each other for students, may be treated differently under the proposed procedure, assuming both schools enroll few, or no, minority students. A solution suggested to meet this objection is that the definition of community be changed to include only those school districts from which a substantial percentage of students are enrolled. If that were the case, a school which did not enroll 20 percent of its students from the district in which it is located would not have that district counted for the purpose of measuring whether or not it had significant minority student enrollment. Some might argue, however, that such a change would allow a private school located in a racially-mixed city, which draws substantially all of its students from white suburbs, to avoid the guidelines.

Finally, with respect to the definition of community, some have argued that for religious schools which restrict enrollment to members of a particular faith, community should be defined in terms of the congregation.

The proposed procedure provides that if a particular school which is part of a "system of commonly supervised schools" does not have significant minority student enrollment, it nonetheless may be treated as having a significant minority enrollment if certain conditions are met. It has been pointed out that this provision could allow an entire school system to qualify as nondiscriminatory under the Revenue Procedure even though it may be made up of separate schools, some of which are composed substantially of minority students and others of which are composed substantially of nonminority students. Because of this, some have suggested that the Revenue Procedure be strengthened to assure that separate schools may be considered on a system-wide basis only when their division into separate schools does not involve a racially discriminatory purpose.

Others believe, however, that the provision regarding school systems should not be changed because it recognizes that individual private schools in a system will vary in the racial mix of their student bodies and, therefore, should be judged as members of a system with a common commitment to the active support of a policy of racial nondiscrimination. Nevertheless, that the nature of the term "system" might be clarified.

C. Constitutional Issues

1. Separation of powers

a. General

A fundamental principle of American constitutional law is the concept of separation of powers. The United States Constitution establishes three divisions of governmental powers in the executive, judicial, and legislative branches. This division of power creates a system of checks and balances among the branches to ensure the independence of each branch and to prevent the concentration of power in a single branch.

The separation of powers necessarily imposes restraint on the authority of one branch to interfere with the functioning of another branch. One particular area of concern is the authority of Congress to intervene in the judicial process or to direct the courts to reach certain decisions. Some have argued that once Congress confers jurisdiction upon the courts, it cannot direct that the jurisdiction be exercised in a manner contrary to, or in disregard of, constitutional requirements.

b. Legislative proposals

Proposals to prohibit IRS procedures to determine racial discrimination and to require specific judicial interpretations of government actions (see S. 103 and S. 449) raise constitutional questions regarding the doctrine of separation of powers with respect to the power of Congress and the authority and jurisdiction of the Federal courts.

Congressional prohibition of the implementation by the Internal Revenue Service of any new guidelines or other administrative rules for determining whether private schools claiming tax-exempt status discriminate racially, through S. 103 or similar legislation, might be interpreted as legislative interference with the Federal judiciary because the proposed revenue procedure was formulated in response to an injunction and order issued by a three-judge United States district court. If, as some have argued, the injunction and court order are based on constitutional grounds, a Congressional ban on the issuance of IRS procedures may interfere with IRS compliance with the court order and may constitute an improper intrusion upon the judicial branch's powers. On the other hand, if the court's injunction and order are based on a statutory interpretation of section 501(c)(3), then Congress may possess the power to modify or prohibit IRS guidelines or rules issued under the statute.

If Congress adopts S. 449 or any similar provision directing the Federal courts to find that no state action (for example, no provision of Federal assistance) occurs when tax-exempt status is granted to a private school, or when tax deductions are allowed for contributions to private schools, controversies could ensue with respect to the power of Congress to interfere with the Federal judiciary. Some have argued that a finding of government or state action is an inherent judicial determination and that any attempt by Congress to direct the courts

to interpret the provision in a narrow manner would be unconstitutional. Such arguments are premised on the fact that Congress may not dilute the rights of individuals under the due process and equal protection clauses of the Constitution. In this view, legislation directing the courts to find that the grant of a tax exemption to private schools does not constitute state action would dilute the rights of minorities under the Fifth Amendment and, therefore, would be unconstitutional.

2. State Action

a. General

Nearly all of the Constitution's safeguards of individual rights are essentially limitations on governmental action.[1]

Because these safeguards are not restraints on persons acting in a private capacity, a person who alleges damage by reason of allegedly unconstitutional activity must show that there is sufficient governmental action (or state action) to bring the constitutional provisions into play. In some cases, state action is obvious, for example, in the operation of public schools. In other cases, the governmental involvement in the conduct complained of may be less obvious. The Supreme Court has indicated that the issue of whether an activity involves state action depends upon the facts and circumstances of each case. In general, it appears that the concept of what is state action is essentially the same for Federal Government as for State or local government authorities.

b. Special tax treatment as state action

There appears to be little direct authority as to whether tax exemptions, or other specific tax benefits [2] afforded to a private party, constitute state action which involves the government in an activity (such as racial discrimination) of the private party. Although direct aid to discriminatory private schools has been found improper by Federal courts in decisions indicating that such aid is considered state action, it is not clear that indirect aid, the grant of tax exemptions (or the denial of tax exemptions) would be so characterized. Generally, challenges to the provisions of tax benefits to racially discriminatory private schools have been decided on other grounds without reaching the state action issue.

The Supreme Court has discussed the general equation of Federal tax benefits with direct aid only in *dicta*. There is some language in

[1] The first eight amendments to the Constitution (the Bill of Rights) limit the conduct of the Federal Government and, to the extent of their incorporation into the due process clause of the Fourteenth Amendment, also are limitations on State governments.

[2] The Internal Revenue Code and, in some cases, other Federal statutes provide that non-profit educational organizations may qualify for several types of favorable treatment. First, such an organization may qualify for tax-exempt status under section 501(a) if it meets the requirements of 501(c)(3) of the Code. Second, such an organization may be eligible to receive contributions for which the donor can receive an income tax deduction under section 170. Also, gifts to such an organization are generally not subject to the estate or gift taxes (secs. 2055, 2106(a)(2) and 2522 of the Code). Third, nonprofit educational institutions are exempt from a number of Federal excise taxes (under sec. 4221(a)(4) of the Code) and from the communications excise tax (under sec. 4253(j) of the Code). Also, employees of organizations described in section 501(c)(3) may take advantage of the special taxation of annuity provisions under section 403(b), and many exempt organizations have the privilege of preferred second or third class mailing rates. See 29 U.S.C. § 4358; 39 C.F.R. parts 132, 134.

the opinions in *Walz* v. *Tax Commission*, 397 U.S. 664 (1970), which would indicate a distinction between tax exemptions and general subsidies. Thus, in the majority opinion, it is pointed out that the abstention from the collection of tax does create a benefit to the organization but will result in less involvement with sustained and detailed administrative relationships for enforcement of statutory or administrative standards than would a governmental grant (397 U.S. at 674–5). It should be noted that the *Walz* case did not involve racial discrimination, and the test for what is an indirect benefit which is prohibited appears to be more stringent in cases involving racial discrimination.[3]

In *Committee for Public Education & Religious Liberty* v. *Nyquist*, 413 U.S. 756 (1973), the Supreme Court indicated that the distinction between direct grants and special tax provisions was not necessarily determinative and that State laws providing for direct tuition grants and special tax benefits (in the nature of a tuition tax credit) to parents of children attending nonpublic schools were in violation of the Establishment Clause.

c. IRS procedures and state action

Some persons have argued that the grant of tax exemption to a private school does provide substantial aid and constitutes state action. Therefore, because of the constitutional prohibition against race discrimination, they believe that such exemptions must be denied to schools which racially discriminate. Some of these persons support the proposed IRS procedures; others believe stronger administrative action is required.

Other persons object to the Internal Revenue Service's proposed procedure as a restraint on First Amendment rights. They believe that children attending such schools and their parents have First Amendment rights of freedom of association (and freedom of religion) which protect the parents' right to educate their children in a school of the parent's choice. They consider the denial of tax benefits to private schools an unconstitutional abridgement of these rights because the imposition of less favorable tax rules for these organizations would unduly influence or penalize the parents' choice schools.

Arguments of this sort have been rejected by the Supreme Court in cases involving State aid of a direct nature. Thus, in *Norwood* v. *Harrison*, 413 U.S. 455 (1973), the Supreme Court held that the right of private schools to exist and operate does not include the right of these schools to receive any share in State aid without regard to constitutionally mandated standards forbidding State-supported discrimination. Also, it seems fairly clear that even indirect State aid to racially discriminatory school is prohibited. Thus, in *Gilmore* v. *City of Montgomery*, 417 U.S. 556 (1974), the Supreme Court prohibited the non-

[3] Some lower court cases have considered the provision of certain Federal tax benefits as generally equivalent to direct Federal assistance. *Green* v. *Connally*, 330 F. Supp. 1150 (D.D.C. 1970). In *McGlotten* v. *Connally*, 338 F. Supp. 448 (D.D.C. 1972), the court held that the tax exemption for fraternal orders (under which all income other than "unrelated business taxable income" is exempt from tax) and the allowances of an income tax deduction to contributions to these organizations (under sec. 170(c)(4)) constituted state action. However, the court indicated that the tax exemption for social clubs (in effect, limited to income from dealings with members) did not constitute state action. *Cf. Jackson* v. *Statler Foundation*, 496 F. 2d 623 (2d Cir. 1974), cert. denied 420 U.S. 927 (1975) (tax exemption and regulation provisions of Internal Revenue Code may constitute state action).

exclusive use of public parks by racially discriminatory private schools.

The Supreme Court does not appear to have spoken directly on the issue of the granting of Federal tax benefits to racially discriminatory organizations, unless its affirmance of *Green* v. *Connally* is treated as adopting the lower court's language. In *Green* v. *Connally*, the district court rejected the claims of the intervening white parents that it would be unconstitutional to deny tax exemption and qualification for tax deductible contributions to racially discriminatory private schools on the basis of earlier Supreme Court rulings. The earlier rulings rejected the First Amendment "right of association" claims which were interposed as objections to court orders ordering the termination of government financial support to segregated private schools.

The weight of authority indicates that there is no constitutional basis for requiring the government to provide tax benefits to racially discriminatory private schools or to donors to such schools.

3. Racial discrimination

a. Court decisions

Racial discrimination in public education was ruled illegal and contrary to public policy in the 1954 Supreme Court decision of *Brown* v. *Board of Education*, 347 U.S. 482 (1954). After that decision, public school systems had little success in evading desegregation orders. Public school desegregation contributed to the creation of private schools and academies with all-white enrollments for the purpose of avoiding desegregation.

Attempts by State and local governments to aid private schools which racially discriminate have been challenged successfully in the courts. The most significant of these cases is *Green* v. *Connally*, 330 F. Supp. 1150 (D.D.C. 1971), *aff'd sub. nom. Coit* v. *Green*, 404 U.S. 997 (1971), which involved a class action by black parents of school children attending Mississippi public schools to enjoin United States Treasury officials from according tax-exempt status and from allowing deductions for contributions to private schools in Mississippi discriminating against black students. In *Green*, the Federal District Court in an opinion affirmed by the Supreme Court, held that racially discriminatory private schools are not entitled to Federal tax exemption and persons making gifts to such schools are not entitled to charitable contributions deductions for such gifts. As a matter of constitutional law, the court found that any amount of State support to help fund segregated schools or to help maintain segregated schools is sufficient to give black school children standing to file a complaint in Federal court attacking the constitutionality of such action.[4]

[4] The court in *Green* stated the "history of state-established segregation in Mississippi, coupled with the founding of new private schools there at times reasonably proximate to public school desegregation litigation, leaves private schools in Mississippi carrying a badge of doubt." The court further stated:

"To obviate any possible confusion, the court is not to be understood as laying down a special rule for schools located in Mississippi. The underlying principle is broader, and is applicable to schools outside Mississippi with the same or similar badge of doubt. Our decree is limited to schools in Mississippi because this is an action on behalf of black children and parents in Mississippi, and confinement of this aspect of our relief to schools in Mississippi applying for tax benefits defines a remedy proportionate to the injury threatened to plaintiffs and their class."

The *Green* court permanently enjoined the Internal Revenue Service from approving any application for tax-exempt status under section 501(c)(3) of the Code for any private school located in the State of Mississippi unless such private school makes a showing in support of its application for exemption:

(1) That the school has publicized the fact that it has a racially nondiscriminatory policy as to students, meaning that it admits the students of any race to all the rights, privileges, programs and activities generally accorded or made available to students at that school, and further meaning, specifically, but not exclusively, a policy of making no discrimination on the basis of race in administration of educational policies, applications for admission, of scholarship and loan programs, and athletic and extra-curricular programs.

(2) That the school has publicized this policy in a manner that is intended and reasonably effective to bring it to the attention of persons of student age (and their families) who are of minority groups, including all nonwhites.

The court further enjoined the IRS from approving any application for tax-exempt status for any private school located in the State of Mississippi unless such school supplied the IRS with specified information, which the court said was material if the Service was to be in an effective position to determine whether the school has actually established a policy of nondiscrimination. The required information was:

(1) Racial composition, as of the pending academic year, and projected so far as may be feasible for the subsequent academic year, of student body, applicants for admission, and faculty and administrative staff.

(2) Amount of scholarship and loan funds, if any, awarded to students enrolled or seeking admission, and racial composition of students who have received such awards.

(3) Listing of incorporators, founders, and board members; donors of land or buildings, whether individuals or organizations; and a statement as to whether any of the foregoing have an announced identification as an organization having as a primary objective the maintenance of segregated school education, or have an announced identification as officers or active members of such an organization.

In *Prince Edward School Foundation* v. *Commissioner*, No. 78–1103 (D.D.C.) decided on April 18, 1979, the court followed the *Green* decision and found a school with a racially discriminatory admissions policy is not entitled to Federal tax exemption.

In *Norwood* v. *Harrison*, 413 U.S. 455 (1973), the Supreme Court held unconstitutional a program in which textbooks were purchased by the State and loaned to students in both public and private schools, including private schools that had racially discriminatory policies.

On remand in *Norwood*, 382 F. Supp. 921 (N.D. Miss. 1974), the district court held that a prima facie case of racially discriminatory policies rendering a private school disqualified for receiving textbooks from the State, arises from proof that the school's existence began close upon the heels of massive desegregation of the public schools within its locale and that no blacks are, or have been, employed as

teachers or administrators at the school. The court further held that once a prima facie case of a racially discriminatory admissions policy is established, so as to disqualify a school from receiving State aid, the school's officials or representatives bear the burden of rebutting the inference of racial discrimination. The court stated that such rebuttal evidence may not be limited to the mere denial of a purpose to discriminate, but must, in order to be effective, clearly and convincingly reveal objective acts and declarations establishing that the absence of blacks was not proximately caused by the school's policies and practices and show affirmative steps instituted by the school to insure the availability of all of its programs to blacks who choose to participate.

In *Runyon* v. *McCrary*, 427 U.S. 160 (1976), the Supreme Court held that a statutory provision, 42 U.S.C.A. sec. 1981, granting all persons the same right to make and enforce contracts, prohibits private, commercially operated, nonsectarian schools from denying admission to blacks and, as so construed, is a permissible exercise of Congress' power to enforce the Thirteenth Amendment.

Recently, in *Goldsboro Christian Schools, Inc.* v. *United States*, 436 F. Supp. 1314 (E.D.N.C. 1977), a district court held that a private school is not entitled to exemption from Federal income tax notwithstanding the religious belief on which its racially discriminatory admissions policy rests.[5]

In another recent case involving a school's qualification under section 501(c)(3), however, the court held improper IRS revocation of the exemption of a religious university which would not admit racially mixed couples. *Bob Jones University* v. *U.S.*, No. 76–775, (D.S.C. December 1978). The decision in this case is being appealed by the government.

b. Criticism of proposed procedure

Although the illegality of granting tax exemption to racially discriminatory private schools generally is acknowledged, the Internal Revenue Service's proposed procedures for reviewing private schools for racial discrimination has been challenged.

It has been suggested that determinations of racial discrimination should be made by the courts, not by the IRS, an administrative agency with limited expertise in civil rights. This approach would restrict IRS denials or revocations of exemptions to schools which have been adjudicated to be racially discriminatory. Some believe that such an approach would cause unnecessary litigation for many cases in which discrimination could be readily determined administratively in significantly less time and at less expense.

Some civil rights spokesmen have criticized the proposed procedure as inadequate for preventing exemptions from being granted to schools which discriminate because of the procedure's limited applica-

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[5] In so holding, the court asserted the following:

"There is a legitimate secular purpose for denying tax exempt status to schools generally maintaining a racially discriminatory admissions policy. Moreover, the general across-the-board denial of tax benefits to such schools is essentially neutral, in that its principal or primary effect cannot be viewed as either enhancing or inhibiting religion. Finally, the policy patently avoids excessive governmental entanglement with and, in fact, prevents indirect government aid to, religion."

bility and its consideration of factors which effectively create exceptions. They note, for example, that schools organized in areas not subject to desegregation plans or established more than a year before the implementation of such a plan would not be reviewable under the procedures and would only be required to fulfill the Service's requirements for publicizing nondiscriminatory policies, which both the Service and courts have recognized as insufficient.

4. First Amendment considerations

Because many private schools claiming tax exemption are religious or church-affiliated organizations, questions have arisen about the relationship between the proposed IRS procedures and the guarantees of individual rights and the limitations on government action established in the First Amendment:

"Congress shall make no law respecting an establishment of religion, or prohibiting the free exercise thereof; . . ."

a. Establishment Clause

The Establishment Clause of the First Amendment prohibits Federal and State governments from setting up a church, from aiding any or all religions, and from preferring one religion over another. In *Walz* v. *Tax Commission*, 397 U.S. 664 (1970), the Supreme Court also held that involvement between church and state can create problems of entanglement which, if excessive, contravenes the Establishment Clause.

Ordinarily, it is the grant of a tax exemption, not its denial, which raises issues under the Establishment Clause about the propriety of such Federal or State aid to a religious institution. Questions about the proposed procedures tend to involve issues of preference for some churches or religions over other churches or religions, and issues of entanglement. The special consideration shown under the guidelines for religious schools organized as part of a system and for religious schools whose specialized pograms would not be attractive to minorities has been criticized as allowing a few religious groups preferential treatment which is not granted to others. These aspects of the guidelines have been defended as reasonable and necessary accommodations of religious and church-related schools which otherwise would be reviewable schools for reasons bearing no relation to racial discrimination. Moreover, by considering these special factors of organization or program in finding a school is not reviewable, the IRS avoids work for both itself and such schools in examinations which would be unnecessary and unfruitful because of the improbability of proving racial discrimination in such circumstances.

Some contend that the proposed procedure should be withdrawn because it entails excessive government intrusion into churches or into religion. Others believe that the procedure reduces such entanglement by providing standards for excepting schools from more intensive examination.

b. Free Exercise Clause

Because of the constitutional protection afforded by the Free Exercise Clause of the First Amendment, the government must eliminate or adapt rules which conflict with the free exercise of religion unless a strong state interest exists for preserving the rule, or unless changing

the rule to accommodate religious beliefs would result in administrative problems which would frustrate the substantial and relevant government purpose for the rule. Although religious beliefs may not be regulated by government, regulation of acts based on religious beliefs or principles has been upheld by the Supreme Court.[6]

The proposed procedure has been criticized as improperly burdening the free exercise of religion by religious groups or churches who, for racially innocent reasons, have few or no minority members. However, the procedures allow for consideration of factors such as special curricula or low minority membership to except schools from reviewable status, if the factors are not based on segregationist motives. Defenders of the procedures believe that these provisions accommodate religious belief sufficiently to counter any challenges under the Free Exercise Clause.

5. Constitutional conflict: race and religion

The revocation or denial of tax exemptions for religious or church-related private schools which are racially discriminatory may bring two constitutional policies into conflict: the guarantees of the First Amendment religion clauses and the prohibition against racial discrimination particularly with respect to education. In resolving conflicting Constitutional demands, the Federal courts either have tried to balance the policies by weighing or evaluating the competing considerations in the controversies or have recognized one of the constitutional policies as more important than the other. Although judicial precedents require the denial of tax-exemptions to racially discriminatory religious schools, some critics of the proposed guidelines contend that the procedures should be more narrowly drawn, for example, limited to adjudicated schools, in order to accommodate First Amendment considerations. Other critics interpret the judicial opinions as inconconclusive.

[6] *Reynolds* v. *United States*, 98 U.S. 145 (1878) (affirming polygamy conviction over the Mormon defendant's religious objection).

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