

Revisiting *Bob Jones University*: Seeking Clarity on  
Fundamental Public Policy After 35 Years  
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Qualification as Charity: Line Drawing and Analytical Structure  
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I. Introduction

In *Bob Jones University v. United States*,<sup>1</sup> the Supreme Court denied charitable tax-exempt status<sup>2</sup> to schools which discriminated against blacks. The majority opinion, by Chief Justice Burger, uses a simple syllogism. As its first premise, it interprets I.R.C. § 501(c)(3)<sup>3</sup> as resting on “certain common law standards of charity, namely, that an institution seeking tax-exempt status must serve a public purpose and not be contrary to established public policy.”<sup>4</sup> As its second premise, it finds that “racial discrimination in education violates a most fundamental national public policy . . . .”<sup>5</sup> From these premises, it concludes that the institutions in question<sup>6</sup> do not qualify for tax exemption under I.R.C. § 501(c)(3).

The Justices were clearly concerned about the ultimate reach of this line of reasoning. Thus, the opinion cautions:

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<sup>1</sup> 461 U.S. 574 (1983) [hereinafter *Bob Jones*].

<sup>2</sup> This phrase is intended to refer to I.R.C. § 501(c)(3) generally.

<sup>3</sup> All references to “I.R.C. §” are to the Internal Revenue Code of 1986, as amended. All references to “Treas. Reg.” are to the most current version, as of September of 2018, of the Treasury Regulations promulgated under the Code.

<sup>4</sup> 461 U.S. at 586.

<sup>5</sup> *Id.* at 593.

<sup>6</sup> The *Bob Jones* opinion involved both Bob Jones University, located in Greenville, South Carolina, and Goldsboro Christian Schools, located in Goldsboro, North Carolina. Neither institution denied that it discriminated on racial grounds; both appear to have claimed that such discrimination was based on sincerely held religious beliefs. *See id.* at 602 n. 28.

“We are bound to approach these questions with full awareness that determinations of public benefit and public policy are sensitive matters with serious implications for the institutions affected; a declaration that a given institution is not ‘charitable’ should be made only where there can be no doubt that the activity involved is contrary to a fundamental public policy.”<sup>7</sup>

Only a few pages later, it repeats the caveat:

“We emphasize, however, that these sensitive determinations should be made only where there is no doubt that the organization’s activities violate fundamental public policy.”<sup>8</sup>

Three aspects of the Bob Jones decision are worth noting: (1) it rests on statutory interpretation, not constitutional, grounds;<sup>9</sup> (2) it deals only with I.R.C. § 501(c)(3) status, not other tax benefits; and (3) it identifies only racial discrimination, not other activities, as violating “fundamental public policy.”

Today, 35 years after the Court spoke, the scope and reach of its decision remain surprisingly unclear. Despite the tremendous potential impact of the Bob Jones decision, it has rarely been applied except in the realm of racial discrimination. The constitutional issues, argued but not decided in Bob Jones, are still largely unexplored. It is as though a massive rock was dropped into a deep lake but produced only a small splash and very few ripples.

This paper will circle warily around some of these issues. Part II contains a brief discussion of the use of public policy notions to deny tax deductions generally. Part III then considers some of the history leading up to the decision in Bob Jones. Part IV addresses selected comments and analyses of the Bob Jones opinion. A conclusion follows in Part V.

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<sup>7</sup> *Id.* at 592.

<sup>8</sup> *Id.* at 598.

<sup>9</sup> The Court explicitly declined to rule on the Constitutional arguments presented to it. *Id.* at 599 n. 24.

## II. Public Policy Denial of Tax Deductions<sup>10</sup>

Although the Bob Jones decision addressed the impact of violations of public policy on tax exemption under I.R.C. § 501(c)(3), it is instructive to consider a different but arguably cognate line of cases addressing the impact of such violations on tax deductions.

As early as 1924, the Board of Tax Appeals denied a tax deduction on public policy grounds.<sup>11</sup> The taxpayer had committed perjury during an investigation of payoffs to union leaders. He claimed a business deduction for the costs of successfully defending himself in a subsequent criminal prosecution. The Court said:

“Manifestly the commission of perjury can, under no circumstances, be recognized as part of a taxpayer’s business; and so the expense incident to such criminal activity can likewise not be recognized. . . . It would be an anachronism to say that such

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<sup>10</sup> Much has been written about disallowance of deductions for public policy reasons. The following articles comprise a sampling: Edward J. Schnee & W. Eugene Seago, Violation of Public Policy and the Denial of Deductions, 42 TAX ADVISER 316 (2011); Robert W. Wood, Denying Deductions Based on Public Policy, 110 TAX NOTES 1415 (2006); Robert W. Wood, Should the Securities Industry Settlement be Deductible?, 99 TAX NOTES 101 (2003); Martin D. Ginsburg, Sex Discrimination and the IRS: Public Policy and the Charitable Deduction, 10 TAX NOTES 27 (1996); William L. Raby, When Will Public Policy Bar Tax Deductions for Payments to Government?, 66 TAX NOTES 1995 (1995); Charles A. Borek, The Public Policy Doctrine and Tax Logic: The Need for Consistency in Denying Deductions Arising From Illegal Activities, 22 U. BALT. L. REV. 45 (1995); John J. Pease, III, Stephens v. Commissioner and the Continuing Confusion Surrounding the Public Policy Doctrine of the Internal Revenue Code, 11 J.L. & COM. 105 (1992); James W. Colleton, The Tax Treatment of Criminal and Disapproved Payments, 9 VA. TAX REV. 273 (1989); Peace & Messere, Tax Deductions and Criminal Activities: The Effects of Recent Tax Legislation, 20 RUTGERS CAMDEN L.J. 415 (1989); Miriam Galston, Public Policy Constraints on Charitable Organizations, 3 VA. TAX REV. 291 (1984); Deal, Reining in the Unruly Horse: The Public Policy Test for Disallowing Tax Deductions, 9 VT. L. REV. 11 (1984); Paul B. Stephan, III, Bob Jones University v. United States: Public Policy in Search of Tax Policy, 1983 SUP. CT. REV. 33, 37-50; Note, The Judicial Public Policy Doctrine in Tax Litigation, 74 MICH. L. REV. 131 (1975); Taggart, Fines, Penalties, Bribes, and Damage Payments and Recoveries, 25 TAX L. REV. 611 (1970); Tyler, Disallowance of Deductions on Public Policy Grounds, 20 TAX L. REV. 665 (1965); Lindsay, Tax Deductions and Public Policy, 41 TAXES 711 (1963); Comment, Business Expenses, Disallowance and Public Policy: Some Problems of Sanctioning With the Internal Revenue Code, 72 YALE L.J. 108 (1962).

<sup>11</sup> Backer v. Commissioner, 1 B.T.A. 214 (1924). There were two dissents; one member of the Board did not participate in the decision. Interestingly, the two dissenters were members of the three-judge panel which heard the case. One of them was Judge Sternhagen, of

an act, so inimical to the public interest as to justify punishment for its commission, may at the same time be so recognized that the expense involved in its commission is sanctioned by the revenue law as an ordinary and necessary expense of carrying on a business. . . . We do not believe that it is in the interest of sound public policy that the commission of illegal acts should be so far protected or recognized that their cost is regarded as a legitimate and proper deduction in the computation of net income under the revenue laws of the United States.”<sup>12</sup>

The decision might have rested solely on the finding that the expense was not incurred in the taxpayer’s trade or business. The public policy argument, however, was a major part of the Court’s opinion, and that opinion has been cited as an early precursor of much of the law that later developed.<sup>13</sup>

An important issue is raised by the first clause of the first sentence quoted above: “Manifestly the commission of perjury can, under no circumstances, be recognized as part of a taxpayer’s business.” If illegal acts are treated as necessarily separate from business activities, i.e., as always constituting an unlawful frolic of the malefactor’s own, two results might follow. The first is clear and intended: no business deduction will be available to the sinner or her organization. The second is less obvious and unintended: the evil acts might not be attributed to the business (or other entity) with which the sinner is associated. This

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blesed memory the author of the initial decision in Gregory v. Commissioner, 27 B.T.A. 223 (1932), *rev’d sub nom.* Helvering v. Gregory, 69 F.2d 809 (2d Cir. 1934), *aff’d sub nom.* Gregory v. Helvering, 293 U.S. 465 (1935).

<sup>12</sup> 1 B.T.A. AT 216-17.

<sup>13</sup> BORIS I. BITTKER & LAWRENCE LOKKEN, FEDERAL TAXATION OF INCOME, ESTATES AND GIFTS ¶ 20.3.3 (Thomson Reuters/Tax & Accounting, 2d/3d ed. 1993-2018, updated July 2018 and visited at [www.checkpoint.riag.com](http://www.checkpoint.riag.com) on July 25, 2018) [hereinafter BITTKER & LOKKEN]. Interestingly, more than 40 years after the Backer decision, the Supreme Court permitted a taxpayer to deduct his costs in defending himself against charges of illegally selling securities. Commissioner v. Tellier, 383 U.S. 687 (1966). *See also* O’Malley v. Commissioner, 91 T.C. 352 (1988) (deduction permitted for costs of defense against criminal charges arising out of taxpayer’s service as unpaid trustee of Teamster’s Pension Fund).

second result would obviously present a substantial obstacle to applying public policy notions to tax-exempt organizations. It thus raises the general question, considered further below,<sup>14</sup> of whether and when illegal acts may be attributed to entities.

The most frequently cited case in the area is Tank Truck Rentals, Inc. v. Commissioner<sup>15</sup> in which the Supreme Court, explicitly relying on notions of public policy, denied deductions for fines paid as a result of violations of state highway maximum-weight laws.<sup>16</sup> Both before and after that decision, however, there were many uncertainties about and inconsistent applications of the rule. A leading treatise attributes this to “a basic flaw in the frustration-of-public-policy doctrine,” i.e., that “[d]enial of the deduction . . . is not needed to preserve the sting of the penalty, but rather is a tax penalty in addition to the original penalty.”<sup>17</sup>

As a result of these doctrinal problems, Congress, in 1969, preempted much of the field by adopting provisions now found, as amended, in I.R.C. §§ 162(c), (f), and (g). These disallow deductions, respectively, for illegal bribes, kickbacks, and other payments; fines and penalties; and two-thirds of the amount of certain antitrust damages.<sup>18</sup> Confusion has not been eliminated altogether, however, for at least two reasons. First, the scope of the preemptive legislation was not total. Although the regulations extend the I.R.C. §

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<sup>14</sup> See text accompanying notes 100 - 108 *infra*.

<sup>15</sup> 356 U.S. 30 (1958).

<sup>16</sup> See also Hoover Motor Express Co. v. United States, 356 U.S. 38 (1958) (same result even for inadvertent violations). But contrast Commissioner v. Sullivan, 356 U.S. 27 (1958) (deductions permitted for wages and rent paid by illegal gambling enterprise). The Bob Jones majority opinion cited Tank Truck Rentals, albeit with an introductory “cf.” signal, in support of its public-policy position. 461 U.S. at 591 n. 17. Justice Powell, in his concurring opinion, also cited to that case. *Id.* at 607 n. 1.

<sup>17</sup> BITTKER & LOKKEN, n. 13, *supra*.

<sup>18</sup> Extended analysis of these provisions is beyond the scope of this paper. See generally BITTKER & LOKKEN, n. 13 *supra*, ¶¶ 20.3.4, 20.3.5, and 20.3.6. See also the articles cited at n. 10, *supra*.

162 subsections to I.R.C. § 212,<sup>19</sup> the Service and the courts have sometimes used the frustration-of-public-policy notion, instead, to disallow losses under I.R.C. § 165.<sup>20</sup> Second, a contrary line of precedent, permitting illegal payments to be added to the cost of goods sold (and thus to be offset against gross receipts in calculating gross income), continues to have legal life.<sup>21</sup>

Thus, either because of the limited scope of the Congressional preemption effort, or because of the vitality of inconsistent lines of authority, it is possible that, but uncertain whether or to what extent, the frustration-of-public-policy doctrine may apply to deny tax benefits afforded under the Code outside of I.R.C. §§ 162 and 212.

### III. Background to Bob Jones

The Supreme Court's action in Bob Jones had an engrossing history. The early part of it is primarily of legal interest;<sup>22</sup> the latter part primarily political.

For more than a decade after Brown v. Board of Education,<sup>23</sup> the IRS appeared to have little interest in the issue of tax exemption for racially discriminatory schools. By the mid-1960's, however, a growing number of segregated private schools had applied to the Service for confirmation of their tax-exempt status. On August 2, 1967, the Service published a News Release stating that it was reviewing the federal tax status of such schools, and that both tax exemption and charitable contribution deductions would be denied "if the operation of the school is on a segregated basis and its involvement with the state or political subdivision is such as to make the operation unconstitutional or a violation of the

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<sup>19</sup> Treas. Reg. § 1.212-1(p).

<sup>20</sup> See, e.g., Rev. Rul. 77-126, 1977-1 C.B. 47; Holmes Enterprises, Inc. v. Commissioner, 69 T.C. 114 (1977). See also BITTKER & LOKKEN, n. 13 *supra*, ¶ 20.3.3, at 20-52 n. 39.

<sup>21</sup> See, e.g., Max Sobel Wholesale Liquors v. Commissioner, 630 F.2d 670 (9th Cir. 1980); Treas. Reg. § 1.61-3(a). See also BITTKER & LOKKEN, n. 13 *supra*, ¶ 20.3.5, at 20-56 n. 52.

<sup>22</sup> Helpful reviews of the history up to the end of the 1960's, together with citations and legal arguments, can be found in Note, Tax Exemptions for Racial Discrimination in Education, 23 TAX L. REV. 399 (1968); Note, Federal Tax Benefits to Segregated Private Schools, 68 COLUM. L. REV. 922 (1968); and Note, The Tax-Exempt Status of Segregated Schools, 24 TAX L. REV. 409 (1969).

<sup>23</sup> 347 U.S. 483 (1954).

laws of the United States.”<sup>24</sup> One possible implication of the quoted language was that such tax benefits would not be lost if the school could sustain itself without any state aid (outside of tax relief).<sup>25</sup> Later in the same year, the Service held that tax-exempt status and charitable contribution deductions would be unavailable for a racially-discriminatory recreational facility.<sup>26</sup>

On January 12, 1970, the Service was preliminarily enjoined, by a three-judge District Court in the District of Columbia, from approving tax exemption for racially discriminatory private schools in Mississippi.<sup>27</sup> In July of the same year, the IRS announced that it would no longer allow tax exemption for any private schools which so discriminate.<sup>28</sup> The three-judge District Court issued its final opinion on June 30, 1971, holding that racially

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<sup>24</sup> I.R.S. News Release, Aug. 2, 1967, 7 CCH STAND. FED. TAX REP. ¶ 6734, reprinted in Tax Exempt Status of Private Schools: Hearings Before the Subcommittee on Oversight of the House Comm. on Ways and Means, 96<sup>th</sup> Cong., 1<sup>st</sup> Sess. 9 (1979). [The hearings are hereinafter cited as “Oversight 1979 Hearings.”]

<sup>25</sup> See Note, Federal Tax Benefits to Segregated Private Schools, 68 COLUM. L. REV. 922, 925-26 (1968). The Note argues that “the IRS need not, and should not, have left upon [sic] this possibility . . . .” *Id.* at 926.

<sup>26</sup> Rev. Rul. 67-325, 1967-2 C.B. 113. See Recent Cases, Taxation, IRS Rules Organization Which Discriminates on Basis of Race Not Charitable, 21 VAND. L. REV. 406 (1968).

<sup>27</sup> Green v. Kennedy, 309 F. Supp. 1127 (D.D.C. 1970), *appeal dismissed sub nom. Cannon v. Green*, 398 U.S. 956 (1970) and *appeal dismissed sub nom. Coit v. Green*, 400 U.S. 986 (1971).

<sup>28</sup> IRS News Release, July 10, 1970, and IRS News Release, July 19, 1970, reprinted in Oversight 1979 Hearings, cited supra at n.24, at 10. The News Releases also denied tax deductions for gifts to such schools. Randolph W. Thrower, who was Commissioner of Internal Revenue in 1970 when the News Release was issued, later testified that “[p]erhaps no other decision made by me received as much study and attention from so many people in so many different departments and agencies of Government . . . .” Administration’s Change in Federal Policy Regarding the Tax Status of Racially Discriminatory Private Schools: Hearing Before the Committee on Ways and Means, House of Representatives, 97th Cong., 2d Sess. 84 (Feb. 4, 1982) (statement of Randolph W. Thrower). [These Hearings are hereinafter cited as the “Ways and Means 1982 Hearings.”]

discriminatory schools in Mississippi were not entitled to tax-exempt status, and that donors to them were not entitled to tax deductions for their gifts.<sup>29</sup> The Court enjoined the Service from approving tax exemption for any such school. The IRS promptly issued Revenue Ruling 71-447<sup>30</sup> adopting the rule of the case. Subsequent Service pronouncements provided procedural guidelines, and strengthened, expanded, and clarified its positions.<sup>31</sup>

In the late 1970's, the Service proposed to publish still further Revenue Procedures,<sup>32</sup> but, in 1980 and before they were finally issued, Congress intervened to cut off appropriations "used to carry out" the proposals.<sup>33</sup> Shortly thereafter, on May 5, 1980, the District Court for the District of Columbia modified and supplemented its original 1971 injunction, requiring the Service to implement procedures stronger and more far

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<sup>29</sup> Green v. Connally, 330 F. Supp. 1150 (D.D.C.) (three-judge court), *aff'd mem. sub nom.* Coit v. Green, 404 U.S. 997 (1971). Although the injunction applied only to Mississippi schools, the Court said that its judgment "is not to be misunderstood as laying down a special rule for schools located in Mississippi," and that the "underlying principle . . . is applicable to schools outside Mississippi." 330 F. Supp. at 1174.

<sup>30</sup> 1971-2 C.B. 230.

<sup>31</sup> Rev. Proc. 72-54, 1972-2 C.B. 834; Rev. Rul. 75-231, 1975-1 C.B. 158; Rev. Proc. 75-50, 1975-2 C.B. 587, modified by Rev. Proc. 2019-22, 2019-22 I.R.B. 1260.

<sup>32</sup> Proposed Revenue Procedure on Private Tax-Exempt Schools, 43 Fed. Reg. 37,296 (Aug. 22, 1978), revised at 44 Fed. Reg. 9,451 (Feb. 13, 1979), corrected at 44 Fed. Reg. 11,021 (Feb. 26, 1979). The controversial nature of the proposals prompted Congressional hearings. See Oversight 1979 Hearings, cited *supra* at n.24. See also Wright v. Regan, 656 F.2d 820, 824-25 (D.C. Cir. 1981), discussing criticisms of the pre-existing standards.

<sup>33</sup> Treasury, Postal Service, and General Government Appropriations Act of 1980, Pub. L. No. 96-74, 93 Stat. 559, 562, 577, §§ 103 and 615. These were referred to as the "Dornan-Ashbrook appropriation riders," after the names of their Congressional sponsors. See Note, The Judicial Role in Attacking Racial Discrimination in Tax-Exempt Private Schools, 93 HARV. L. REV. 378 (1979). The 1980 appropriations ban was extended for fiscal 1981. Pub. L. No. 96-536, 94 Stat. 3166 (1980). The co-sponsors, Rep. Dornan and Rep. Ashbrook, both indicated that their riders were not intended to interfere with the ability of the Service to continue to revoke tax exemption of racially discriminatory schools pursuant to the Service's pre-1978 Revenue Rulings and Procedures. 125 Cong. Rec. H5879, 5882 (July 13, 1979, daily ed.) (statement of Rep. Ashbrook); 125 Cong. Rec. H5982 (July 16, 1979, daily ed.) (statement of Rep. Dornan).

reaching than those previously in effect to prevent racially discriminatory schools from being tax-exempt.<sup>34</sup> The resulting situation was succinctly described by Ex-Commissioner Randolph Thrower:

“Thus, the Service is presently in the position of being prohibited by one branch of the government to act while being ordered to do so by another. The end result is a dual system: one method of review for Mississippi schools based on Green II, and another method for the rest of the country based, until recently, on procedures in effect prior to August 22, 1978, and now on no policy whatsoever.”<sup>35</sup>

The direct history of the Bob Jones decision is fascinating.<sup>36</sup> Its early stages followed closely on the heels of the IRS announcements, in 1970, that racially-discriminatory schools would no longer be entitled to tax-exempt status. Bob Jones University commenced an action, in 1971, seeking to enjoin the Service from revoking the University’s tax exemption. That suit was ultimately held to be barred by the anti-injunction provisions of the Code.<sup>37</sup>

Then, on January 19, 1976, the Internal Revenue Service issued a final notice of revocation of tax-exempt status to Bob Jones University, effective from December 1, 1970. On May 4, 1976, Bob Jones University filed suit in federal District Court in South Carolina seeking a refund of \$21 in federal unemployment taxes. The United States counter-claimed for approximately \$480,000 in such taxes for the years 1971 through 1975.<sup>38</sup> The District Court, on December 26, 1978, held Bob Jones University qualified for tax exemption, entered judgment for the University in the refund suit, and ordered the Secretary of

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<sup>34</sup> Green v. Miller, 80-1 U.S.T.C. ¶ 9401, 45 A.F.T.R.2d 1566 (D.D.C. 1980) (not officially reported).

<sup>35</sup> Ways and Means 1982 Hearings, cited *supra* at n. 28, 104-05 (statement of Randolph W. Thrower). See also *id.* at 254 (statement of Roscoe L. Egger, Jr., Commissioner of Internal Revenue).

<sup>36</sup> Much of the direct history is recounted in the Bob Jones opinion itself. See 461 U.S. at 581-82.

<sup>37</sup> The Supreme Court, applying I.R.C. § 7421(a), so held in Bob Jones University v. Simon, 416 U.S. 725 (1974).

<sup>38</sup> At that time, I.R.C. § 501(c)(3) organizations were sometimes exempt from social security taxes. The exemption was removed by the Social Security Amendments of 1983, Pub. L. No. 98-21, § 102(b)(1), 97 Stat. 65, 70-71, repealing I.R.C. § 3121(b)(8)(B).

the Treasury and Commissioner of Internal Revenue Service to restore the University's tax-exempt status.<sup>39</sup>

On December 30, 1980, the Court of Appeals for the Fourth Circuit, in a 2-1 decision, reversed, held that Bob Jones University was not entitled to tax exemption, and entered judgment for the Government.<sup>40</sup> Bob Jones University filed a petition for a writ of certiorari to the Supreme Court on July 1, 1981. The U.S. government supported the University's petition, arguing that, although there was no conflict in the Circuits, the Supreme Court should affirm the decision below and confirm that the IRS had acted within its statutory authority in revoking the University's tax-exempt status. Certiorari was granted on October 13, 1981.<sup>41</sup>

Up to the end of 1981, the government had consistently followed its long-standing policy of denying I.R.C. § 501(c)(3) status to racially discriminatory schools. However, in an astonishing about-face, on January 8, 1982, the Reagan Administration announced that it was changing its position, and henceforth would grant such schools tax exemption.<sup>42</sup> This, it explained, would moot the proceedings in Bob Jones and Goldsboro. The same day, it filed a memorandum with the Supreme Court asking that the judgments be vacated as moot. Its memorandum stated, in part:

“Since the filing of our brief acquiescing in the granting of certiorari in these cases, the Department of the Treasury has initiated the necessary steps to grant petitioner

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<sup>39</sup> 468 F. Supp. 890 (D.S.C. 1978).

<sup>40</sup> 639 F.2d 147 (4th Cir. 1980).

<sup>41</sup> 454 U.S. 892 (1981). The companion case, Goldsboro Christian Schools, was granted certiorari on the same date. *Id.*

<sup>42</sup> Treasury News Release (Jan. 8, 1982), reprinted in *Ways and Means 1982 Hearings*, cited *supra* at n.28, 607-08. The ensuing discussion, in the text, above, covers only selected highlights of the relevant developments. For descriptions of the background to the change in government position, as set forth by two of its principal proponents, see *Ways and Means 1982 Hearings*, cited *supra* at n. 28, 153-59 (statement of Edward C. Schmults, Deputy Attorney General, Department of Justice) and 178-81 (statement of Robert T. McNamar, Deputy Secretary of the Treasury). For further details, see P. TREUSCH, *TAX-EXEMPT CHARITABLE ORGANIZATIONS* 164-79 (3d ed. 1988); U.S. COMMISSION ON CIVIL RIGHTS, *DISCRIMINATORY RELIGIOUS SCHOOLS AND TAX EXEMPT STATUS* 5-9 (Clearinghouse Pub. 75, Dec. 1982).

Goldsboro Christian Schools tax-exempt status under Sec. 501(c)(3) of the Code, and to refund to it federal social security and unemployment taxes in dispute. Similarly, the Treasury Department has initiated the necessary steps to reinstate tax-exempt status under Sec. 501(c)(3) of the Code to petitioner Bob Jones University, and will refund to it federal social security and unemployment taxes in dispute. Finally, the Treasury Department has commenced the process necessary to revoke forthwith the pertinent Revenue Rulings that were relied upon to deny petitioners tax-exempt status under the Code.”<sup>43</sup>

A few days later, after a fire-storm of criticism, the Administration said it would submit legislation to Congress to authorize the IRS to deny tax exemption to schools which discriminate on racial grounds.<sup>44</sup> The proposed legislation was released January 18, 1982.<sup>45</sup> The Administration’s summary states, in part, that its proposed legislation “will, for the first time, give the Secretary of the Treasury and the Internal Revenue Service express authority to deny tax-exempt status to private, nonprofit educational organizations with racially discriminatory policies.”<sup>46</sup>

Congressional hearings were urgently scheduled to consider the Administration’s change of position and its legislative proposal. On February 1, 1982, two Reagan Administration witnesses appeared before the Senate Finance Committee. As one source reported:

“Administration witnesses testified on February 1 that the IRS lacks the statutory authority to deny tax exemptions to private schools that practice racial discrimination. According to Deputy Attorney General Edward C. Schmults and Deputy Treasury Secretary R. T. McNamar, the Administration felt compelled to reverse the 11-year-old policy on private schools after their review of the issue led them to

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<sup>43</sup> Reprinted in Ways and Means 1982 Hearings, cited *supra* at n. 28, 616, at 617 (footnote omitted).

<sup>44</sup> Statement by President Reagan, Jan. 12, 1982, reprinted in Ways and Means 1982 Hearings, cited *supra* at n. 28, 620.

<sup>45</sup> See Reagan Proposes Bill to Prohibit Tax Exemption for Discriminatory Schools, 14 TAX NOTES 218 (Jan. 25, 1982).

<sup>46</sup> Tax Exemption Bill Summary, reprinted in Ways and Means 1982 Hearings, cited *supra* at n. 28, 624-25.

the conclusion that ‘there is neither a constitutional nor statutory basis for the practice followed by the Internal Revenue Service since 1970.’”<sup>47</sup>

Further, “[s]pecifically, Schmults stated that section 501(c)(3) does not require an educational or religious organization to also meet [sic] the standards of a common law charity.”<sup>48</sup>

Because the Administration’s position clearly indicated that it would not vigorously support the decisions below, and in line with suggestions contained in at least one brief amicus curiae,<sup>49</sup> the Supreme Court appointed William T. Coleman, Jr., to argue the case as counsel for the judgments below.<sup>50</sup> Although unusual, the Court’s *sua sponte* appointment of Mr. Coleman is not without precedent. A fairly recent essay, discussing the history and practice of such appointments, found that “[a]pproximately once each Term — with a notable increase in frequency in recent years — the Court appoints an amicus curiae when one party to a case declines to participate at all, or to advance a particular argument, in a case pending before the Court.”<sup>51</sup>

In the meantime, and still prior to the Supreme Court’s decision in the case, the Administration directed the IRS to grant tax exemption to Bob Jones University and the

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<sup>47</sup> Administration Defends Tax-Exempt School Policy Switch, 14 TAX NOTES 338 (Feb. 8, 1982).

<sup>48</sup> *Ibid.*

<sup>49</sup> The brief was filed by Professors Bernard Wolfman and Lawrence Tribe of the Harvard Law School.

<sup>50</sup> This is reflected in note 24 to the opinion of the Supreme Court, 461 U.S. at 599. The process leading up to the appointment of Mr. Coleman is described in detail in Katherine Shaw, Essay, Friends of the Court: Evaluating the Supreme Court’s Amicus Invitations, 101 CORNELL L. REV. 1533, 1553-55 (2016). The Court’s memo appointing Mr. Coleman can be found at 456 U.S. 922 (1982).

<sup>51</sup> Shaw, *supra* n. 50, at 1548. See also Brian P. Goldman, Note, Should the Supreme Court Stop Inviting Amicus Curiae to Defend Abandoned Lower Court Decisions?, 63 STAN. L. REV. 907 (2011).

Goldsboro schools, and to revoke its contrary rulings. The Service was slowly and carefully considering this directive,<sup>52</sup> when, on February 18, 1982, it was prevented from complying with it. The D.C. Circuit Court of Appeals enjoined the Service from granting tax-exempt status to any racially-discriminatory school.<sup>53</sup> Ironically, the injunction was later reversed by the Supreme Court, which held that the plaintiffs in that suit lacked standing.<sup>54</sup> It remained in place, nevertheless, long enough to preserve the *status quo* pending the Supreme Court's decision in Bob Jones.

#### IV. Selected Comments and Analyses

Much has been written about the Bob Jones decision; much of what has been written is critical of the opinion.<sup>55</sup> It is outside the scope of this paper to revisit most of those issues. In addition, because the agenda for this October 2018 conference includes others' papers and presentations on many of the important ramifications of the Bob Jones deci-

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<sup>52</sup> Commissioner Roscoe L. Egger, Jr., and Chief Counsel Kenneth Gideon disagreed with the Administration's reversal of position, and stated their opposition both to the Administration officials favoring the about-face and to members of Congress. *See Ways and Means 1982 Hearings*, cited *supra* at n.28, 256, 259 (testimony of Roscoe L. Egger, Jr., Commissioner of Internal Revenue).

<sup>53</sup> Wright v. Regan, No. 80-1124 (Feb. 18, 1982) (*per curiam* order). This is reflected in note 9 to the opinion of the Supreme Court, 461 U.S. at 585. The injunction is reproduced in the *Ways and Means 1982 Hearings*, cited *supra* at n.28, at 363-64.

<sup>54</sup> Allen v. Wright, 468 U.S. 737 (1984), *reversing* Wright v. Regan, 656 F.2d 820 (D.C. Cir. 1981).

<sup>55</sup> *See, e.g.*, David A. Brennan, The Power of the Treasury: Racial Discrimination, Public Policy, and "Charity" in Contemporary Society, 33 U.C. DAVIS L. REV. 389 (2000); Charles O. Galvin & Neal Devins, A Tax Policy Analysis of *Bob Jones University v. United States*, 36 VAND. L. REV. 1353 (1983); Mayer G. Freed & Daniel D. Polsby, Race, Religion, and Public Policy: *Bob Jones University v. United States*, 1983 SUP. CT. REV. 1; Paul B. Stephan, III, *Bob Jones University v. United States*: Public Policy in Search of Tax Policy, 1983 SUP. CT. REV. 33.

sion, this paper will endeavor to sidestep those ramifications in the interest of avoiding repetitiveness. Thus, only a few comments and analyses selected by the author, within those constraints, will be addressed here.

The unimportance of “fundamental.” The title of this conference refers to “fundamental public policy,” and that is, indeed, one of the formulations employed by Chief Justice Burger in his opinion for the majority.<sup>56</sup> He also used several other adjectives to modify “public policy” however: “clearly defined,”<sup>57</sup> “established,”<sup>58</sup> “settled,”<sup>59</sup> “national,”<sup>60</sup> “firm,”<sup>61</sup> and “declared.”<sup>62</sup> It seems likely that the Chief Justice viewed all of those adjectives to be substantially equivalent. On that assumption, the search for clarity about the scope and reach of the Bob Jones opinion should not turn on a narrow scrutiny of the meaning of the word “fundamental.”<sup>63</sup>

The importance of eight. I.R.C. § 501(c)(3) lists eight types of organizations eligible to receive exemption from federal income taxes: (1) religious, (2) charitable, (3) scientific, (4) testing for public safety, (5) literary, (6) educational, (7) fostering national or international amateur sports competition, and (8) for the prevention of cruelty to children or animals. The majority opinion in Bob Jones refers to “the eight categories expressly set forth in that section . . . .”<sup>64</sup> The dissenting opinion also alludes to “the eight enumerated purposes.”<sup>65</sup> I.R.C. § 170(c)(2)(B), however, lists — in language identical to that in I.R.C. §

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<sup>56</sup> 461 U.S. at 592, 593, 594, 598.

<sup>57</sup> *Id.* at 582.

<sup>58</sup> *Id.* at 586.

<sup>59</sup> *Id.* at 585, 591.

<sup>60</sup> *Id.* at 593, 601.

<sup>61</sup> *Id.* at 598.

<sup>62</sup> *Id.* at 591 n.17.

<sup>63</sup> Chief Justice Burger also used the phrase “fundamental public policy” in his dissenting opinion in Moore v. City of East Cleveland, Ohio, 431 U.S. 494, 525 (1977).

<sup>64</sup> *Id.* at 585; *see also id.* at 587 n. 11 (“the eight categories of institutions specified in the statute . . . .”).

<sup>65</sup> *Id.* at 613.

501(c)(3) — only seven types of organizations, omitting organizations testing for public safety. Several observations:

- Given the differences between I.R.C. § 170(c)(2)(B) and I.R.C. § 501(c)(3), the majority’s use of the former to illuminate the meaning of the latter is a bit questionable, as Justice Rehnquist, in dissent, noted by stating that the majority opinion “quite adeptly avoids the statute it is construing.”<sup>66</sup> The Chief Justice nevertheless wrote that “surely there can be no doubt that the Court properly looks to §170 to determine the meaning of §501(c)(3).”<sup>67</sup> Surely that “surely” is wrong.<sup>68</sup>
- The omission from I.R.C. § 170(c)(2)(B) of organizations testing for public safety is consequential: donations to such organizations are not tax deductible.<sup>69</sup> (Justice Powell, concurring in Bob Jones, erroneously wrote that tax deductions *would* be available for donations to testing organizations.<sup>70</sup>) Such organizations are also exempted from the private foundation rules in Chapter 42 of the Code per I.R.C. § 509(a)(4). Deleting such organizations from I.R.C. § 501(c)(3) would thus be wise, but — given that they have been included for so long — such a deletion is unlikely to occur. As a result, testing organizations are also probably treated as charities for state law purposes since many states (and the Model Nonprofit Corporation Act<sup>71</sup>)

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<sup>66</sup> *Id.* at 612.

<sup>67</sup> *Id.* at 587 n. 11. The Service, in Rev. Rul. 71-447, 1971-2 C.B. 230, had also relied on the language of I.R.C. § 170(c) in interpreting I.R.C. § 501(c)(3).

<sup>68</sup> Judge Henry Friendly correctly observed that “where the Internal Revenue Code is concerned, no controlling weight can be given to the usual presumption that, when the same words are used in several sections of a statute, they mean the same thing.” Sirbo Holdings v. Commissioner, 509 F.2d 1220, 1223 (2d Cir. 1975). His caution applies *a fortiori* when the language in the two sections is not identical, as is the case with I.R.C. §§ 170(c)(2)(B) and 501(c)(3).

<sup>69</sup> Rev. Rul. 65-61, 1965-1 C.B. 234; G.C.M. 32,399 (Sept. 21, 1962), modified by G.C.M. 32,519 (Feb. 20, 1963).

<sup>70</sup> 461 U.S. at 606.

<sup>71</sup> The third edition of the Model Nonprofit Corporation Act revised the definition of “charitable purpose” from the second edition. As revised, it now defines a charitable purpose as “a purpose that would make a corporation operated exclusively for that purpose eligible to be exempt from taxation under Section 501(c)(3) or (4) of the Internal Revenue

borrow from I.R.C. § 501(c)(3) in defining charities in their nonprofit or tax or other legislation.<sup>72</sup> In addition, even in states — like New York — that do not treat such organizations as charitable,<sup>73</sup> they are likely to be subject to Attorney General oversight because, in addition to testing, they almost always engage in educational activities and those activities would classify them as charitable and thus subject to registering and reporting to the Attorney General.

- It is possible for an organization to qualify under more than one of the eight enumerated categories. For example, Chief Justice Burger wrote that Bob Jones University “is both a religious and educational institution.”<sup>74</sup>
- The majority held that “entitlement to tax exemption depends on meeting certain common-law standards of charity . . . .”<sup>75</sup> It might be tempting to understand this as elevating the second enumerated category — “charitable” organizations — above the other seven categories. A careful reading shows this interpretation to be wrong. Rather, the Court intended that such “common-law standards of charity” would be

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Code.” MODEL NONPROFIT CORPORATION ACT § 1.40(6)(i) (3d ed. 2008). The prior edition had enumerated qualifying purposes, but the current edition opted instead to define such purposes by cross-reference to the Code or other applicable law. MODEL NONPROFIT CORPORATION ACT at 1-46 (3d ed. 2008). Thus, organizations testing for public safety are treated as charitable under that Act.

<sup>72</sup> E.g., Cal. Rev. & Tax Code § 23701(d)(1)(A) (West 2018); Tex. Tax Code Ann. § 11.18(g)(4)(B) (West 2018); Idaho Code § 41-120(b) (2018) (dealing with insurance).

<sup>73</sup> None of (i) the New York Charitable Solicitation Law (Exec. L. § 171-a(1)), (ii) the New York Estates, Powers & Trusts Law (EPTL §§ 8-1.1(a) & 8-1.4(a)), or (iii) the New York Not-for-Profit Corporation Law (NPCL § 102(a)(3-b)) include testing organizations within their definitions of charitable purposes or charitable organizations subject to supervision by the Attorney General. A 2015 memorandum from Lawyers Alliance for New York suggested that the Not-for-Profit Corporation Act’s definition of “charitable purposes” should be amended explicitly to include organizations that test for public safety. Memorandum from Lawyers Alliance for New York to Senator Ranzenhofer and Assemblymember Brennan (April 28, 2015) (on file with author). That change was not made part of the amendments to the Non-profit Revitalization Act of 2013, Assembly Bill No. A8072, ch. 549, 2013 N.Y. Laws 1400.

<sup>74</sup> *Id.* at 580, 605 n. 32 (at 606).

<sup>75</sup> *Id.* at 586.

applicable to each of the eight enumerated categories, including the “charitable” category (even though that seems tautological).<sup>76</sup> Chief Justice Burger wrote: “While the eight categories of institutions specified in the statute are indeed presumptively charitable in nature, the IRS properly considered principles of charitable trust law in determining whether the institutions in question may truly be considered ‘charitable’ for purposes of entitlement to the tax benefits conferred by §170 and §501(c)(3).”<sup>77</sup> The Tax Court<sup>78</sup> and the IRS<sup>79</sup> agree.

Thus, a two-tier analysis is required to determine whether a given organization is entitled to tax exemption under I.R.C. § 501(c)(3). First, the organization must be scrutinized to see whether it properly fits within one or more of the eight enumerated categories. Then, second, the organization must be scrutinized to see whether, in addition, it complies with what the Court described as “principles of charitable trust law.”<sup>80</sup>

We know a bit about the first test for certain of the categories. For example, we know something about the requirement in the Treasury Regulations that an educational organization must present “a sufficiently full and fair exposition of the pertinent facts as to permit an individual or the public to form an independent opinion or conclusion.”<sup>81</sup> After

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<sup>76</sup> *Accord*, R. Charles Miller, Comment, Rendering Unto Caesar: Religious Publishers and the Public Benefit Rule, 134 U. PA. L. REV. 433, 445 (1986).

<sup>77</sup> *Id.* at 587 n. 11. *See also id.* at 592 n. 19 (“To be entitled to tax-exempt status under §501(c)(3), an organization must first fall within one of the [eight] categories specified by Congress, and in addition must serve a valid charitable purpose.”)

<sup>78</sup> The Tax Court has stated that “[w]e believe the Bob Jones opinion unqualifiedly held that all organizations seeking exemption under 501(c)(3) must comply with fundamental standards of public policy.” Church of Scientology of California, 83 T.C. 381, 503 n. 74 (1984), aff’d on other grounds, 823 F.2d 1310 (9th Cir. 1987), cert. denied, 486 U.S. 1015 (1988)

<sup>79</sup> G.C.M. 39792 (Aug. 17, 1987) (“The Court’s opinion in Bob Jones leaves little doubt that discrimination on the basis of race, whether in an educational context or otherwise, violates a public policy so fundamental as to justify denial of charitable status to any organization otherwise exempt under section 501(c)(3).”)

<sup>80</sup> 461 U.S. at 597.

<sup>81</sup> Treas. Reg. § 1.501(c)(3)-1(d)(3)(i).

that standard was declared void for vagueness on constitutional grounds,<sup>82</sup> the Service promulgated a so-called “methodology test”<sup>83</sup> that several courts subsequently blessed as curing the void-for-vagueness problem of the full-and-fair-exposition language.<sup>84</sup> These precedents occasioned a substantial amount of analysis in legal journals.<sup>85</sup>

We now know that an “educational organization,” for purposes of I.R.C. § 170(b)(1)(A)(ii), does not have to satisfy either the primary-function requirement or the merely-incidental test set forth in Treas. Reg. § 1.170A-9(c)(1). The District Court, in

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<sup>82</sup> Big Mama Rag, Inc. v. United States, 631 F.2d 1030 (D.C. Cir. 1980).

<sup>83</sup> Rev. Proc. 86-43, 1986-2 C.B. 729.

<sup>84</sup> Nat’l Alliance v. United States, 710 F.2d 868 (D.C. Cir. 1983); Retired Teachers Legal Defense Fund, Inc., 78 T.C. 280 (1982); Nationalist Movement v. Commissioner, 102 T.C. 558, *aff’d per curiam on other grounds*, 37 F.3d 216 (5th Cir. 1994), *cert. denied*, 513 U.S. 1192 (1995).

<sup>85</sup> *See, e.g.*, Alex Reed, Playing Devil’s Advocate: The Constitutional Implications of Requiring Advocacy Organizations to Present Opposing Viewpoints, 37 N.Y.U. REV. L. & SOC. CHANGE 591 (2013); Alex Reed, Subsidizing Hate: A Proposal to Reform the Internal Revenue Service’s Methodology Test, 17 FORDHAM J. CORP. & FIN. L. 823 (2012); Lynn Lu, Flunking the Methodology Test: A Flawed Tax-Exemption Standard for Educational Organizations that “Advocate a Particular Position or Viewpoint”, 29 N.Y.U. REV. L. & SOC. CHANGE 377 (2004); Brian A. Hill, First Amendment Vagueness and the Methodology Test for Determining Exempt Status: *Nationalist Movement v. Commissioner*, 48 TAX LAW. 569 (1995); D. Benson Tesdahl, When is the Advocacy of Controversial Issues an “Educational” Activity?, PHILANTHROPY MONTHLY, January/February 1994, at 31; Daniel Shaviro, From *Big Mama Rag* to *National Geographic*: The Controversy Regarding Exemptions for Educational Publications, 41 TAX L. REV. 693 (1986); Thompson, The Availability of the Federal Tax Exemption for Propaganda Organizations, 18 U.C. DAVIS L. REV. 487 (1985); Robert D. Kamenshine, Free Expression v. Tax Exemption: Is Trade-off Fair?, 11 MEDIA L. NOTES 4 (1984); Liles, Court Holds Definition of “Educational” in Reg. to be Unconstitutionally Vague, 54 J. TAX’N 61 (1981); Note, *Big Mama Rag, Inc. v. United States*: An Inquiry Into Vagueness, 67 VA. L. REV. 1543 (1981); Note, Federal Income Taxation — Tax-exempt Status for Educational Organizations — The Definition of Educational Organizations in Treasury Regulation Section 1.501(c)(3)-1(d)(3) is Unconstitutionally Vague in Violation of the First Amendment, 49 GEO. WASH. L. REV. 623 (1981); Peter H. Winslow & Robert L. Ash, Effects of the *Big Mama Rag* Decision on Exempt Education Organizations: An Analysis, 55 J. TAX’N 20 (1981); Note, Tax Exemptions for Educational Institutions: Discretion and Discrimination, 128 U. PA. L. REV. 849 (1980).

Mayo Clinic v. United States,<sup>86</sup> held that “the Treasury Department exceeded the bounds of its statutory authority when it promulgated the primary-function requirement and merely-incidental test . . . .”<sup>87</sup> That decision has been appealed to the 8<sup>th</sup> Circuit Court of Appeals; the appeal was argued on Oct. 20, 2020.

We also know something about the criteria for being treated as a “scientific” organization because the relevant regulations provide a reasonable amount of guidance<sup>88</sup> and other precedents are also available.<sup>89</sup> There is an extremely modest amount of regulatory guidance — just one sentence — about what constitutes “testing for public safety.”<sup>90</sup> None of the five other categories receives any attention whatsoever in the relevant regulations. Indeed, those regulations enumerate only seven of the eight categories, altogether omitting any mention of organizations fostering national or international amateur sports competition.<sup>91</sup>

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<sup>86</sup> 412 F. Supp. 3d 1038 (D. Minn.2019).

<sup>87</sup> *Id.* at 1052.

<sup>88</sup> Treas. Reg. § 1.501(c)(3)-1(d)(5).

<sup>89</sup> *E.g.*, IIT Research Inst. v. United States, 9 Cl. Ct. 13, 85-2 U.S.T.C. ¶ 9734, 56 A.F.T.R.2d 85-6023 (Cl. Ct. 1985); Midwest Research Inst. v. United States, 554 F. Supp. 1379 (W.D. Mo. 1983), *aff'd*, 744 F.2d 635 (8<sup>th</sup> Cir. 1984); Dumaine Farms v. Commissioner, 73 T.C. 650 (1980), *acq. in part & non-acq. in part*, A.O.D. 1980-45, 1980-2 C.B. 1; Rev. Rul. 76-296, 1976-2 C.B. 142; Rev. Rul. 65-1, 1965-1 C.B. 226.

<sup>90</sup> Treas. Reg. § 1.501(c)(3)-1(d)(4).

<sup>91</sup> Treas. Reg. § 1.501(c)(3)-1(d)(1)(i). The category of organizations fostering national or international amateur sports competition was added to I.R.C. § 501(c)(3) by the Tax Reform Act of 1976, Pub. L. No. 94-455, § 1313, 90 Stat. 1520, 1730 (1976). The Treasury Regulations under I.R.C. § 501(c)(3) have been amended five times since 1975, but none of the amendments added such sports organizations to the enumeration of organizations in the above-cited regulation. T.D. 7428, 41 Fed. Reg. 34618 (Aug. 16, 1976); T.D. 8308, 55 Fed. Reg. 35579-01 (Aug. 30, 1990); T.D. 9390, 73 Fed. Reg. 16519 (March 27, 2008); T.D. 9674, 79 Fed. Reg. 37630-01 (July 1, 2014); T.D. 9819, 80 Fed. Reg. 29730-01 (June 30, 2017). For an historical review of the tax-exempt status of such sports organizations, see Robert C. Moot, Jr., Note, Tax-Exempt Status of Amateur Sports Organizations, 40 WASH. & LEE L. REV. 1705 (1983).

Illegal Activities. The ruling that first stated the I.R.S.'s policy against tax-exempt status for racially discriminatory schools rested both on illegality and on violations of public policy: "All charitable trusts . . . are subject to the requirement that the purpose of the trust may not be illegal or contrary to public policy."<sup>92</sup> This duality was repeated in Rev. Rul. 75-384<sup>93</sup> holding that an antiwar protest organization was not entitled to tax exemption when its primary activity included encouraging acts of civil disobedience. The ruling said that "[t]he purpose is illegal if the trust property is to be used for an object which is in violation of the criminal law, or if the trust tends to induce the commission of crime, or if the accomplishment of the purpose is otherwise against public policy."<sup>94</sup> Finding that the organization's activities involved "violations of local ordinances and breaches of public order," the ruling declared that the organization was not charitable. Thus, the illegality test is distinct from the public-policy test,<sup>95</sup> and for this purpose illegality can occur without any criminal act being committed.

Because this October 2018 conference focuses on the Bob Jones public policy test, it is not appropriate to explore the illegality test in depth here.<sup>96</sup> A few questions about the illegality test may be raised, however, for further consideration at another time:

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<sup>92</sup> Rev. Rul. 71-447, 1971-2 C.B. 230. This language was quoted with approval by the Tax Court in Church of Scientology of California, 83 T.C. 381, 508-09 (1984), *aff'd on other grounds*, 823 F.2d 1310 (9th Cir. 1987), *cert. denied*, 486 U.S. 1015 (1988).

<sup>93</sup> 1975-2 C.B. 204. The ruling is supported by G.C.M. 36153 (Jan. 31, 1975).

<sup>94</sup> Defining "illegality" by reference to public policy obviously blurs the line between what this paper argues are two distinct tests: one for illegal activities and the other for violations of public policy.

<sup>95</sup> Rev. Rul. 80-278, 1980-2 C.B. 175, holds that an "organization's activities will be considered permissible under section 501(c)(3)" only if "the activities are not illegal, contrary to a clearly defined and established public policy, or in conflict with express statutory restrictions . . . ."

<sup>96</sup> Interested readers are referred to the two leading cases applying the illegal-activities test to revoke an organization's tax-exempt status: Church of Scientology of California, *op. cit. supra* n. 78, and Synanon Church v. United States, 579 F. Supp. 967 (D.D.C. 1984), *aff'd*, 820 F.2d 421 (D.C. Cir. 1987). See also Mysteryboy, Inc. v. Commissioner, 99 T.C.M. (CCH) 1057 (2010).

- Does the act in question have to be illegal under federal law, or would a state (or municipal) law suffice?<sup>97</sup> Would a pro-choice charity jeopardize its federal tax exemption as a result of carrying on some of its activities in a town which enacted an ordinance providing that counseling on family planning or abortion was a violation of law? It seems clear that, at least in some cases, violations of state or local law may be grounds for loss of tax exempt status. What are the limits to that doctrine, e.g., if the law in question unconstitutionally purports to limit the charity's speech?
- Does the illegal act have to be *malum in se* or is it sufficient if it is *malum prohibitum*? Suppose a charitable shelter for unwed pregnant teens encouraged its staff drivers to exceed the stated speed limit when driving girls to the hospital once they went into labor?
- What sorts of "breaches of public order,"<sup>98</sup> not involving violation of a criminal statute or local ordinance, might trigger the test? Would the test be met by using a loudspeaker or megaphone on a Sunday afternoon to amplify to passers-by the speech of an educational organization's executive director?
- Might the illegality test expand to subsume the public policy test? For example, there are many statutes that forbid certain types of discrimination and, even if no

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<sup>97</sup> One of the Service's CLE Texts, discussing challenging the tax-exempt status of I.R.C. § 501(c)(6) organizations for illegal activities, states that "the IRS is not in a position to make a determination as to the illegality of an act under a provision of law other than the Internal Revenue Code. That is a matter for the judiciary." J. Activities That are Illegal or Contrary to Public Policy, 1985 (FOR FY 1986) EXEMPT ORGANIZATIONS CPE TECHNICAL INSTRUCTION PROGRAM TEXTBOOK 109, 119. The quoted language closely tracks language from G.C.M. 37111 (May 4, 1977). On the other hand, Rev. Rul. 75-384, 1975-2 C.B. 204, relied in part on a finding that an organization committed "violations of local ordinances and breaches of public order" in holding that the organization did not qualify for tax exemption under I.R.C. § 501(c)(4); PLR 201740002 (Oct. 6, 2017) relied on the organization's violation of regulations promulgated under the Trading With the Enemy Act in holding that its tax exemption should be revoked; Mysteryboy, Inc. v. Commissioner, *op. cit. supra* n. 96, relied on violations of both state and federal law in holding that the organization was not eligible for tax exemption; and G.C.M. 34631 (Oct. 4, 1971) held that "[a] great many violations of local pollution regulations" would be grounds for disqualifying an organization from tax-exempt status.

<sup>98</sup> The quoted language comes from Rev. Rul. 75-384, 1975-2 C.B. 204.

criminal sanction is prescribed for violating them, might violations threaten loss of tax exemption under the illegality test? An article in the Service's CPE text for FY 1994 states that

“[t]he illegality doctrine contains two distinct parts. . . . [I]t prohibits both illegal activities and those that, while not necessarily illegal, are contrary to a fundamental public policy. . . . In most situations, the activity in question has violated a law, so the underlying public policy simply lends weight to the illegality argument rather than having to stand alone.”<sup>99</sup>

Attribution. In the Bob Jones litigation, neither Bob Jones University nor Goldsboro Christian Schools challenged the finding that their policies constituted racial discrimination. Instead, both claimed that their racially discriminatory policies “were based on a genuine belief that the Bible forbids interracial dating and marriage.”<sup>100</sup> Thus, the Bob Jones court had no need to consider whether the conduct or actions of the agents or employees of the petitioners, in maintaining such policies, were properly attributable to the petitioner organizations.

In many other cases, however, a crucial question will be whether the acts of employees, officers, directors, or other agents of an organization should be treated as acts of the organization itself for purposes of either the public policy test or the illegality test. As the I.R.S.'s 1985 CPE text stated:

“[A]ctions by members and officers of an organization do not always reflect on the organization. Because organizations act through individuals, it is necessary to distinguish those activities of individuals that are done in an official capacity from those that are not. Only (1) acts by an organization's officials under actual or purported authority to act for the organization, (2) acts by agents of the organization within their authority to act, or (3) acts ratified by the organization should be considered as activities ‘of the organization.’”<sup>101</sup>

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<sup>99</sup> Jean Wright & Jay H. Rotz, Illegality and Public Policy Considerations, 1993 (FOR FY 1994) EXEMPT ORGANIZATIONS CPE TECHNICAL INSTRUCTION PROGRAM TEXTBOOK 155, 162 (emphasis in original) [hereinafter Wright & Rotz].

<sup>100</sup> 461 U.S. at 602 n. 28.

<sup>101</sup> J. Activities That are Illegal or Contrary to Public Policy, 1985 (FOR FY 1986) EXEMPT ORGANIZATIONS CPE TECHNICAL INSTRUCTION PROGRAM TEXTBOOK 109, 110. See also the discussion in Wright & Rotz, *supra* note 99, at 166-67.

G.C.M. 36153,<sup>102</sup> supporting Rev. Rul. 75-384, states that “[i]t is necessary, however, to establish that the [activities in question] are attributable to the organization, if exemption is to be denied on this ground. . . . Members’ individual acts unratified by the organization cannot be considered acts of the organization.” G.C.M. 34523<sup>103</sup> agrees, stating that “it is necessary to distinguish those activities of individuals that are done in an official capacity, from those that are not. Only official acts can be attributed to the organization.”

The law has long permitted attribution of agents’ acts to the corporations for which they were acting (under the doctrine of *respondeat superior*) for purposes of both tort and criminal liability.<sup>104</sup> The U.S. Attorneys’ Manual sets forth the tests to be used by prosecutors in deciding whether to bring criminal charges against a corporation:

“[A] corporation may be held criminally liable for the illegal acts of its directors, officers, employees, and agents. To hold a corporation liable for these actions, the government must establish that the corporate agent’s actions (i) were within the scope of his duties and (ii) were intended, at least in part, to benefit the corporation. In all cases involving wrongdoing by corporate agents, prosecutors should not

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<sup>102</sup> Jan. 31, 1975.

<sup>103</sup> June 11, 1971.

<sup>104</sup> For an extended and trenchant analysis of the relevant precedents and policies, see Harry First, General Principles Governing Criminal Liability of Corporations, Their Employees and Officers, in WHITE COLLAR CRIME: BUSINESS AND REGULATORY OFFENSES §§ 5.02 & 5.03 (Otto G. Obermaier, Robert G. Morvillo, Robert J. Anello & Barry A. Bohrer eds. 2018).

limit their focus solely to individuals or the corporation, but should consider both as potential targets.

“Agents may act for mixed reasons—both for self-aggrandizement (direct and indirect) and for the benefit of the corporation, and a corporation may be held liable as long as one motivation of its agent is to benefit the corporation.”<sup>105</sup>

The Manual then proceeds to list ten factors to be considered in deciding whether to prosecute the corporation<sup>106</sup> and it also provides an extensive analysis of each of the ten factors.<sup>107</sup>

Prosecuting an organization criminally would appear to be much harsher than challenging the organization’s tax-exempt status, so it could be argued that it should be easier to attribute agents’ actions to the organization for purposes of the illegality or public-policy tests than for deciding whether to prosecute the organization. On the other hand, loss of tax-exempt status may cause severe adverse consequences to innocent staff, charitable beneficiaries, holders of tax-exempt bonds issued by the organization, and others.<sup>108</sup> In any event, while the standards may differ for attribution of agents’ acts to an organization for criminal versus tax purposes, the standards elaborated in the U.S. Attorneys’ Manual may be referred to for at least analogous guidance in crafting standards for the tax-exemption rules.

Other I.R.C. § 501(c) Organizations. The focus of this paper and this conference is on I.R.C. § 501(c)(3) organizations, but the potential reach of the Bob Jones opinion extends beyond them. For example, Rev. Rul. 75-384<sup>109</sup> held that an organization that engaged in illegal activities could not qualify for tax exemption under either I.R.C. § 501(c)(3) or I.R.C. § 501(c)(4), and the 1985 CPE Text discusses applying the illegality

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<sup>105</sup> U.S. ATTORNEYS’ MANUAL, PRINCIPLES OF FEDERAL PROSECUTION OF BUSINESS ORGANIZATIONS § 9-28.210(b), visited at <http://tinyurl.com/y7vtvs2j> on Sept. 10, 2018.

<sup>106</sup> *Id.* at § 9-28.300.

<sup>107</sup> *Id.* at §§ 9-28.400 – 9-28.1500.

<sup>108</sup> It was in recognition of these unintended consequences that the so-called intermediate sanctions provisions in I.R.C. § 4958 were enacted.

<sup>109</sup> 1975-2 C.B. 204. The ruling was cited with approval and followed in PLR 201740002 (Oct. 6, 2017).

test to organizations described in I.R.C. §§ 501(c)(5), 501(c)(6), and 501(c)(7).<sup>110</sup> Are there organizations described in yet other paragraphs of I.R.C. § 501(c) that might be subject to either the public policy or illegality tests? It seems clear that no negative implication arises from the 1976 statutory amendment adding I.R.C. § 501(i) forbidding any § 501(c)(7) social club from discriminating on the basis of race, color, or religion:<sup>111</sup> both the majority opinion in Bob Jones<sup>112</sup> and Justice Powell’s concurring opinion<sup>113</sup> reason, to the contrary, that by adding I.R.C. § 501(i) Congress ratified and acquiesced in the Service’s position that racial discrimination was inconsistent with tax exempt status.

## V. Conclusion

As noted above, 35 years after the Bob Jones decision, we still know very little about the scope and reach of the decision. That is the result of two factors: (1) the government’s only rare invocation of the case to challenge an organization’s tax-exempt status and (2) the lack of standing of any person other than the I.R.S. to bring such a challenge. The first is no doubt largely due to the opinion’s caveats about the sensitivity of determinations of public policy<sup>114</sup> and the Service’s obvious nervousness and timidity about advancing such challenges. The papers by Rich Schmalbeck and Lloyd Mayer will touch on the first. The second is the subject of Marc Owens’s paper tomorrow.

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<sup>110</sup> J. Activities That are Illegal or Contrary to Public Policy, *op. cit. supra* n. 97, pp. 118-21. *See also* Wright & Rotz, *supra* note 99, at 173-77.

<sup>111</sup> McGlotten v. Connally, 338 F. Supp. 448 (D.D.C. 1972), had held that the tax exempt status of I.R.C. § 501(c)(7) social clubs was not lost even if such clubs discriminated on the basis of race. To overturn that decision, Pub. L. 94-568, 90 Stat. 2697, § 2(a) (Oct. 20, 1976) added what is now I.R.C. § 501(i) to the Code. That section has been criticized as being too narrow since it only forbids such discrimination if it is evidenced in “the charter, bylaws, other governing instrument of such organization or any other written policy statement of such organization . . . .” I.R.C. § 501(i). *See, e.g.*, David J. Herzig & Samuel D. Brunson, Tax Exemption, Public Policy, and Discriminatory Fraternities, 35 VA. TAX REV. 116, 129-45 (2015).

<sup>112</sup> 461 U.S. at 601.

<sup>113</sup> *Id.* at 607 and n. 2.

<sup>114</sup> In addition to the caveats in the majority opinion (*see* text accompanying notes 7 and 8, *supra*), Justice Powell’s opinion argued that the Service lacked “expertise . . . to determine the scope of public policy.” 461 U.S. at 611-12.

I look forward to those presentations, the views of the commentators, and the discussions among all of the participants in this conference.