Bob Jones Revisited Federal Public Policy: The IRS Historic Challenge to Racially Discriminatory Private Schools

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Introduction

It has been 17 years since the historic Supreme Court decision in *Bob Jones University v. United States* and the companion case of *Goldsboro Christian Schools v. United States,* 461 U.S. 54 (1983). The Court ruled that the operation of a racially discriminatory private school in violation of the public policy against racial discrimination in education could not qualify as a charitable organization under section 501(c)(3).

An IRS field office recently raised the question of whether the Kamehameha Schools operated by the Bernice Pauahi Bishop Estate that restrict admission to children of Hawaiian ancestry is inconsistent with the requirements of tax exemption under section 501(c)(3) of the Internal Revenue Code of 1986. The Service in a well-reasoned technical advice memorandum held that this preference was not the type of pervasive racial discretion that violates the public policy against racial discrimination in education. /1/ The real question might be asked as to why was this issue even raised in the light of Service history on this matter?

David A. Brennan in an expansive paper entitled "The Power of the Treasury: Social Discrimination, Public Policy and `Charity' In Contemporary Society" /2/ questions whether the IRS or Treasury have the power short of specific legislation to deny the benefits of tax-exempt status to charities that racially discriminate in violation of established federal public policies and how the IRS or Treasury might be applying that rationale to other issues. This analysis is helpful in reviewing the correctness of the IRS finding in the Kamehameha Schools that a preference limiting admission only to those of Hawaiian ancestry is not the type of pervasive racial discrimination that precludes an organization from establishing tax exemption under section 501(c)(3).

It would be well to revisit the application of the federal public policy doctrine as it applies to the exemption of organizations described in section 501(c)(3), in light of this technical advice memorandum and the currently pending United States Supreme Court review of *Rice v. Cavetano,* 963 F. Supp. 1547 (1997), *aff'd* 146 F.3d 1075 (9th Cir. 1999) regarding whether a voting limitation imposed by the State of Hawaii only to those of Hawaiian ancestry for whose benefit the trust was established creates a prohibited racial preference in special trustee elections. It is important to understand not only the rationale of *Bob Jones* but also the historical context in which the IRS formulated its position and the application of the federal public policy to tax issues.

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Private Schools

Brown v. Board of Education, 347 U.S. 483 (1954), struck down state laws mandating "separate but equal" public schools through separate black and white school systems. Before 1970, a number of states were not vigorously enforcing the desegregation of the public school systems as required by *Brown*. The language in the *Brown* decision requiring the states to institute integration of the public school systems "with all deliberate speed" was in fact more "deliberate" than "speedy." With some states initiating massive resistance to integration, the IRS began to see a movement toward creation of "white-only" academies, predominantly in the southern states but also in the northern cities. In the south the issue was further complicated by the fact that parents were concerned that certain religious values should be taught in the public schools. The Supreme Court had struck down mandated prayer in public schools in *Abington School District v. Schempp,* 374 U.S. 203 (1963).

On the one hand, the Lawyers Committee for Civil Rights, representing black parents in class action suits like *Green v. Connally,* 330 F.Supp 1150 (D.D.C. 1971), *aff'd sub nom, Coit v. Green,* 404 U.S. 997 (1971), urged the IRS to take more aggressive action against racially discriminatory schools. On the other hand, parents were forming their own schools, many of which were based on biblical interpretation that encouraged separation of the races. The Service was in the middle of this struggle as these schools applied for tax exemption and the deductibility of contributions. These schools presented serious federal policy questions and constitutional issues of whether the government could grant a tax privilege to schools that violated the public policy against racial discrimination in education. The Service initially took a cautious approach by denying tax exemption only to those schools that received government support. But the federal court decisions made it clear that even *de facto* school segregation could lead to court ordered desegregation. The white-only private schools stood as a haven in those desegregating public school districts. *Norwood v. Harrison,* 382 F.Supp. 921 (N.D. Miss 1974), *on remand from the Supreme Court,* 413 U.S. 455 (1973); *Brumfield v. Dodd,* 405 F.Supp. 388 (E.D. La. 1975).

Encouraged by the Nixon White House, which saw the formation of these schools as a roadblock to its plan for public school desegregation, the IRS published its position denying exemption to racially discriminatory private schools in Rev. Rul. 71-447, 1971-2 C.B. 230. Rev. Rul. 71-447 was based on the common law concepts of charity -- that all charitable trusts, educational or otherwise, are subject to the requirement that their purpose may not be illegal or contrary to public policy. The IRS based its conclusion regarding racially discriminatory schools on the general premise that racial discrimination in education is contrary to federal public policy. The revenue ruling advances three premises in order to reach this conclusion:

1) An educational trust must be a common law charity in order to be exempt under IRC 501(c)(3);

2) Every charitable trust is subject to the requirement that its purpose may not be illegal or contrary to public policy; and

3) As reflected in numerous federal statutes and court cases, there is a clear public policy against racial discrimination, whether public or private.

Looking to federal legislation, executive orders, and federal court interpretation of the civil rights law, the IRS determined that there was an established federal public policy against racial discrimination in education. Whether a school was racially discriminatory was determined by applying certain factors contained in Rev. Proc. 72-54, 1972-2 C.B. 834.

In 1975, the U.S. Commission on Civil Rights criticized the IRS because it lacked specific guidelines to identify whether

schools were operated on a racially discriminatory basis. This resulted in the issuance of Rev. Proc. 75-50, 1975-2 C.B. 587, requiring certain affirmative evidence that a private school was open to all students without regard to race; otherwise, it violated the public policy against racial discrimination in education. The IRS interpretation was pitted directly against the concept of a constitutional guarantee of freedom of association and the free exercise of religion. The private school issue had come before the Supreme Court on several occasions, including *Coit v. Green* (Mississippi schools); *Bob Jones University v. Simon,* 416 U.S. 725 (1974) (injunctive relief from IRS action); *Wright v. Regan,* 468 U.S. 737 (1984) (nationwide class action suit); the *Prince Edward School Foundation,* 450 U.S. 944 (1981) (Virginia segregated academy); and *Runyon v. McCrary,* 427 U.S. 160 (1976) (Supreme Court held that the Civil Rights Act of 1866 made it illegal for private schools to deny admission to blacks). In all of these cases the court found that pervasive racial discrimination violated public policy.

The IRS was now in a position to have the Supreme Court rule specifically on the merits of using the federal public policy test to determine qualification for tax-exempt status announced in Rev. Rul 71-447 and whether the concept of charity subsumed the other categories of charity in order to apply the theory that charitable organizations could not engage in illegal activities and have the benefits of tax-exempt status. Bob Jones University and Goldsboro Christian Schools were making their way through the appeals courts and were consolidated for hearing by the Supreme Court. These institutions also were religious private schools. In early 1982, the Reagan administration announced that it was abandoning the IRS position because the IRS lacked the authority without congressional action to adopt this rule. Up to this point, the federal appellate courts had uniformly sustained the IRS rulings position.

Thus, Bob Jones University and Goldsboro Christian Schools were to be tax exempt and the Supreme Court docketed case was declared moot by the Department of Justice. Five weeks later, following appeals by civil rights organizations, the Appeals Court for the Federal District in *Wright v. Regan,* 49 A.F.T.R.2d 827 (D.C. Cir. 1982), ordered the administration not to recognize the schools' tax-exempt status. The administration asked the Supreme Court to consider the question of tax exemption.

To the dismay of a substantial segment of the legal community, the general public, and to the IRS itself -- Commissioner Roscoe Egger had unsuccessfully sought to defend the IRS position and dissuade Ed Meese and the White House Staff from this course of action. The Department of Treasury and the Department of Justice joined in the ill-fated attempt to reverse the tide of private school desegregation by reversing the 12 years of IRS rulings policy and brazenly attempted to ignore the federal court decisions that had supported this policy. The Administration's action only strengthened the resolve of the civil rights community to defend against this attack. William T. Coleman, an outstanding Philadelphia attorney who had been a trial lawyer for the NAACP Legal Defense Fund and a Secretary of Transportation under President Ford, was selected by the Supreme Court to argue the IRS position as an *amicus* while the Department of Justice joined the schools' attorneys in opposing the IRS adverse action. The Court sustained the IRS position that racially discriminatory schools did not qualify for tax-exempt status under section 501(c)(3) on an 8-1 vote with only Judge Rehnquist dissenting. (*Bob Jones University v. United States,* and *Goldsboro Christian Schools, Inc. v. United States,* 461 U.S. 574 (1983).)

This was not an era without its political impact on IRS administration. Congress passed appropriation riders to the IRS budget that forbade the Service from enacting even more stringent private school guidelines that it had developed in 1978, under the leadership of Commissioner Jerry Kurtz, that attempted to conform IRS procedures with current federal court decisions to test whether schools were really available to students without regard to race.

Racially Restricted Scholarship Trusts

The question of exemption qualification under IRC 501(c)(3) also raised a number of questions about private scholarship trusts with racial restrictions. Thus, the question of preferences on the basis of national origin or religion in the context of private scholarship trusts presented additional complexities that were not necessarily reached by the federal public policy against racial discrimination in education.

As we have seen, the *Green* and *Bob Jones* courts articulated the basis of the public policy against racial discrimination found in the 13th and 14th Amendments to the Constitution, the Civil Rights Acts of 1866, 1870, and 1964, and *Brown v. Board of Education,* 347 U.S. 483 (1954), and its numerous legal progeny. The courts had also repeatedly and consistently struck down every form of state involvement with, and assistance for, racially discriminatory private schools. See *Gilmore v. City of Montgomery* (relating to exclusive use of city recreational facilities by segregated private school), and *Norwood v. Harrison* (textbook assistance to private discriminatory schools). The Supreme Court has also held that under the Civil Rights Act of 1866, private schools may not deny admission on the basis of race. See *Runyon v. McCrary,* 427 U.S. 160 (1976). Also, where state authorities act as trustees of a racially restricted private educational trust, the trust will be invalidated on constitutional grounds. *Pennsylvania v. Board of Directors,* 353 U.S. 230 (1957). Numerous federal regulations also prohibit racial discrimination in the provision of educational assistance. See, for example, 45 C.F.R. Section 80.3(b).

In view of this broad public policy against racial discrimination in education, it could be said that a corollary principle exists for concluding that a racially restricted private scholarship trust may not qualify for exemption under IRC 501(c)(3). The basis for this is found in the long-standing rule that every charitable trust is subject to the requirement that its purposes may not be illegal or contrary to public policy which should be equally applicable to private scholarship trusts that restrict grants on the basis of race. However, there are equally plausible arguments for concluding that a racially restricted scholarship trust should not *per se* be deemed incompatible with exemption under IRC 501(c)(3). It cannot be said that a private trust whose beneficiaries are given preference because they belong to a particular category necessarily fosters racial discrimination in education unless it can be shown that such policy significantly derogates from a school's general racially nondiscriminatory policy. Accordingly, governmental programs have been created to aid those individuals who have been subject to past acts of racial discrimination and have been specifically designated as objects of government support. In this category are Native American Indians, Native Hawaiians and blacks because of racial discrimination. Therefore, if a school or charitable organization accomplishes its tax-exempt purpose through programs that assist a statutorily defined minority that the government wishes to aid, such action is not pervasively discriminatory as to violate the school's racially nondiscriminatory policy as to students. /3/

It is equally true that programs that have been instituted to aid minorities to remedy prior acts of discrimination have come under close review by the Courts in such cases as *Regents of the University of California v. Bakke,* 438 U.S. 205 (1978) (racial preferences in higher education); *Fullilove v. Klutznick,* 448 U.S. 446 (1970) (affirmative action for minority hiring) and *Ararand Contractors, Inc. v. Pena,* 515 U.S. 200 (1995) (race-based affirmative action in granting governmental contracts). Currently under review by the Supreme Court is *Rice v. Cavetano, supra* (state restrictions on the voting in special trustee elections). The Court has historically taken the approach that all racial classifications are not invalid. They must come under "strict scrutiny" standard of the Court to determine if they are constitutional because they are sufficiently narrowly tailored measures that further compelling governmental interests. *Ararand, supra* at 227.

The advancement of education has universally been held to be a purpose "of such social interest to the community as to fall within the concept of charity." Restatement (Second), Trusts Section 368 comment b (2d ed. 1959) (Restatement); Bogert, Trusts & Trustees Section 375 (2d ed. 1964) (Bogert); IV Scott on Trusts Section 270 (3d ed. 1967) (Scott). While the law and society favor protection of the ability to create educational trusts, a trust for the advancement of education will not be a charitable trust if the beneficiaries are not of a sufficiently large or indefinite class so that the community is benefited and interested in the enforcement of the trust. Restatement Section 370; Bogert, Section 375 at 117-118; Scott Section 370.6.

As a general proposition, the courts have upheld the validity of a private gift for charitable purposes despite a provision in the trust indenture limiting or excluding beneficiaries on the basis of race. 15 Am. Jur. 2d Exclusion of Beneficiaries on Basis of Race or Religion Section 74 (1976); Restatement Section 370; Bogert Section 375 at 117-118; Scott Section 370.6; Annot., Validity and Effect of Gift For Charitable Purposes which Excludes Otherwise Qualified Beneficiaries Because of their Race or Religion, 25 A.L.R. 3d 736 (1969 and Supp. 1980).

There appears to be no case involving a private scholarship trust in which such a racial limitation or exclusion was declared invalid or illegal; rather in the large majority of cases in which such a limitation was at issue, the courts utilized the equitable doctrine of *cy pres* to strike out the racial limitation or exclusion on grounds such as impracticability or impossibility of administration. See, e.g., *Lockwood v. Killian,* 179 Conn. 62 (1979); *Pennsylvania v. Brown,* 392 F. 2d 120 (3d Cir.), *cert. denied,* 391 U.S. 921 (1968) (affirmed District Court judgment enjoining trustees of Girard College from denying admission to otherwise qualified applications on the basis of their race).

The courts appear to find racial limitations as "impossible" or "impracticable." However, where state action is involved, the courts have not been hesitant in characterizing such provisions as invalid on constitutional grounds. In this regard, the IRS has adopted a similar position in an analogous situation in section 4.05 of Rev. Proc. 75-50, which states that:

> Financial assistance programs favoring members of one or more racial groups that do not significantly derogate from the school's racially nondiscriminatory policy similarly will not adversely affect the school's exempt status.

In one unpublished ruling the IRS has held that where a racially restricted private scholarship trust provides financial assistance through the grant program of a major university that practices a racially nondiscriminatory policy as to students, it would be difficult to characterize the trust as discriminatory *per se.* However, if such a trust was related to a school that had a racially discriminatory policy, the conclusion would be unavoidable that the trust distribution would result in a contribution to racial discrimination in education. Also, if a school had a racially nondiscriminatory policy, but the restricted trust accounted for a large share of financial assistance, the trust could be deemed as detracting from the school's racially nondiscriminatory policy and deemed non-exempt on that basis.

Conclusion

The Supreme Court has cautioned that the public policy argument has its limits. In *Ararand* it struck down several programs that aided socially and economically disadvantaged individuals because such preferences led to racial discrimination against people who are not members of that group. The Court in *Bob Jones* took great care in limiting the circumstances in which the IRS should act in applying the public policy rationale in their decision making only to those situations where there is no doubt that an organization's activity violates a fundamental public policy where the government has a compelling interest. The Court concluded that racial discrimination in education is such an activity that gives rise to the applica-

tion of public policy rule as shown by the numerous federal legislative enactments and Executive Branch Orders that have been upheld in an unbroken list of cases. While the IRS and Treasury have held that certain illegal activities will defeat tax-exempt status, the government has not applied the violation of the federal public policy doctrine to other than cases of racial discrimination. To apply this concept to other areas of exempt organization activities would require a rigorous court review and daunting task as indicated by William Coleman in his oral argument in the *Bob Jones* case. When asked about the use of this principle in other than racial discrimination cases, he said "We didn't fight a civil war in these other areas" that led to the development of the federal policy.

Footnotes

/1/ The organization recently released the technical advice memorandum on its web site. It was not published by the IRS because it is not a section 6110 issue and is not covered by section 6104 because it is an affirmation of tax-exempt status. See www.ksbe.edu.

/2/ The article will be published in a forthcoming UC Davis Law Review Vol. 33, 2000.

/3/ Native Hawaiian Education Act, 20 U.S.C. 7901, Native American Languages Act of 1974, 25 U.S.C. 2901 *et seq.;* American Indian Religious Freedom Act, 42 U.S.C. 299; and Native Hawaiian Health Care Act of 1988, 42 U.S.C. 1170 *et seq.* (Supp. 1997).

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as possible. To the extent you conclude that the resolution of any of these issues is sufficiently clear that published guidance is not necessary, a general information letter addressed to the Council explaining the IRS's position would be greatly appreciated. From our members' perspective, a written response from the IRS on each issue we have raised is essential.

Thank you for giving us the opportunity to make recommendations for the Business Plan. We look forward to working with you to get this item published and to increase the flow of guidance generally.

Sincerely,

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cc: Steve Arkin
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