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Federal Taxation—*Bob Jones University v. United States*: Segregated Sectarian Education and IRC Section 501(c)(3)

In *Brown v. Board of Education*[1] the Supreme Court held that segregating public school students on the basis of race denied them educational opportunities in contravention of the equal protection clause of the fourteenth amendment. When courts and government agencies acted to implement the *Brown* directive, racially segregated private schools proliferated, especially in the South, in an attempt to thwart desegregation efforts.[2] Recognizing the serious threat that the advent of segregated private schools posed to the *Brown* mandate, the Internal Revenue Service (IRS) eliminated one incentive to their establishment by adopting a policy of denying tax-exempt status[3] to private schools that practice racial discrimination.[4]

The policy gained judicial approval in *Green v. Connally*,[5] in which the district court held that denial of tax-exempt status to a segregated private school was a valid means of furthering the government's compelling interest in discouraging such practices. In *Green*, however, the court did not address "the hypothetical inquiry whether tax-exempt or tax-deduction status may be available to a religious school that practices acts of racial restriction because of the requirements of religion."[6] That inquiry poses a difficult predicament. The court would have to examine the constitutionally guaranteed freedom of religion and equal protection of the law, and determine the proper balance of the countervailing propositions.[7] The result necessarily would protect one in derogation of the other.

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1. 347 U.S. 483 (1954).

2. *See* U.S. COMMISSION ON CIVIL RIGHTS, SOUTHERN SCHOOL DESEGREGATION 1966-1967, at 70-76 (1967) (documenting the growth in the number of segregated private schools with the increased pressure to effect *Brown*). *See also* Comment, *Federal Tax Benefits to Segregated Private Schools*, 68 COLUM. L. REV. 922, 924-25 (1968) ("The establishment of these schools was not due to a sudden awakening to a need for quality private education." Rather, the schools represented concerted efforts to resegregate education.).

3. For an explanation of tax-exempt status and its advantages see *infra* text accompanying notes 10-18.

4. IRS News Release (July 10, 1970), *reprinted in* 7 STAND. FED. TAX REP. (CCH) ¶ 6790 (1970); IRS News Release (July 19, 1970), *reprinted in* 7 STAND. FED. TAX REP. (CCH) ¶ 6814 (1970). The policy was formalized in Rev. Rul. 447, 1971-2 C.B. 230 and Rev. Proc. 54, 1972-2 C.B. 834 and subsequently refined in Rev. Rul. 231, 1975-1 C.B. 158 and Rev. Proc. 50, 1975-2 C.B. 587.

5. 330 F. Supp. 1150 (D.D.C.), *aff'd sub nom.* Coit v. Green, 404 U.S. 997 (1971).

6. *Id.* at 1169.

7. If a court found that a statute did grant tax-exempt status to discriminatory religious schools, it would then have to determine whether free exercise of the religion outweighed the violation of the equal protection clause of the fifth amendment (assuming that indirect support of segregation in education through the grant of tax-exempt status is government action and a violation of equal protection under *Brown*). The competing interests have been analyzed in Note, *First Amendment—Free Exercise Clause—Conflict with 42 U.S.C. § 1981*, 9 N. KY. L. REV. 381 (1982); Comment, *The Tax-Exempt Status of Sectarian Educational Institutions that Discriminate on the Basis of Race*, 65 IOWA L. REV. 258 (1979); and Comment, *Section 1981 After* Runyon v. McCrary*: The Free Exercise Right of Private Sectarian Schools to Deny Admission to Blacks on Account of Race*, 1977 DUKE L.J. 1219.

In *Bob Jones University v. United States*[8] the Supreme Court had the opportunity to settle the inherent conflict between the constitutional grants of freedom of religion and equal protection of the law in the context of the tax-exempt status of segregated schools. Instead, the Court chose to defuse the conflict by focusing on the narrower issue of statutory construction and held that the statute defining the exemption requirements must be read in light of the established public policy against segregation in education. Consequently, organizations not in compliance with this policy cannot qualify for tax-exempt status under the statute.[9]

This note analyzes the Supreme Court's use in *Bob Jones* of legislative history and public policy to justify its interpretation of the statute granting tax-exempt status. The note also examines the ramifications of injecting public policy into the statutory construction process and the consequences of vesting important policy decisions in administrative agencies.

Federal revenue laws have excluded certain organizations from taxation since 1894.[10] Section 501(c)(3) of the Internal Revenue Code currently exempts from taxation all of the following entities:

> [C]orporations, and any community chest, fund, or foundation, organized and operated exclusively for religious, charitable, scientific, testing for public safety, literary, or educational purposes, or to foster national or international amateur sports competition . . . , or for the prevention of cruelty to children or animals, no part of the net earnings of which inures to the benefit of any private shareholder or individual, no substantial part of the activities of which is carrying on propaganda, or otherwise attempting to influence legislation. . . .[11]

Although such tax-exemption provisions long have existed, they have produced little legislative history. Presumably, the provisions became an accepted part of the revenue laws because they promote the social welfare "in much the same manner as when public funds are properly expended."[12] In other words, not taxing certain organizations accomplishes the same objectives as levying a tax and disbursing the funds to promote a public benefit.

Several advantages accrue to organizations that qualify for tax-exempt status. First, income generated from operations is not subject to federal in-

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8. 103 S. Ct. 2017 (1983).

9. By holding that the statute did not grant tax-exempt status to discriminatory religious schools, the Court did not have to address the constitutional conflict described in note 7, *supra*. The only constitutional issue remaining was whether denial of tax-exempt status was a permissible governmental regulation of the university's religious practices. *See infra* text accompanying notes 60-63.

10. The original exemption from federal taxation was the Tariff Act of 1894, ch. 349, § 32, 28 Stat. 556 (1895), which provided that "nothing herein contained shall apply to . . . corporations, companies, or associations organized and conducted solely for charitable, religious, or educational purposes." Every revenue act since then has contained substantially the same exemption. *See* I.R.C. § 501(c)(3) (1982).

11. I.R.C. § 501(c)(3) (1982).

12. Reiling, *Federal Taxation: What Is a Charitable Organization?*, 44 A.B.A. J. 525, 595 (1958).

come tax.[13] Corporate income is usually subject to tax at progressive rates ranging from fifteen percent to forty-six percent.[14] Federal tax-exempt status may automatically qualify the organization for an exemption from state and local taxes including income, franchise, property, and sales and use taxes.[15] In addition, individuals and corporations may take a limited deduction for contributions to organizations qualifying for exempt status under section 501(c)(3).[16] Finally, wages paid by an exempt organization are excluded from the Federal Insurance Contributions Act[17] and the Federal Unemployment Tax Act.[18]

Bob Jones University was incorporated in 1952 as a nonprofit corporation under the laws of South Carolina.[19] The university offers instruction to more than 5,000 students from kindergarten through graduate school and employs a staff in excess of 850. The university adheres to fundamentalist religious beliefs that control every facet of education and campus life.[20] Each course is taught in accordance with these beliefs, and each potential student and faculty member is screened carefully to determine whether his religious background and beliefs conflict with the convictions of the university.

Throughout its history, the university has believed that the Bible forbids interracial dating and marriage. To further this belief, the school denied admission to all blacks unless they were married and had been a member of the staff for at least four years. After *McCrary v. Runyon*,[21] which held that private schools could not refuse admission to blacks on the basis of race, the

13. This advantage often does not constitute as large a factor as may first appear. Most exempt organizations are nonprofit, operating at or near the break-even point. Any income tax liability (if a tax were imposed) would probably be minimal.

14. I.R.C. § 11 (1982).

15. This factor is significant because several state levies are not based on income. *Cf. supra* note 13.

16. I.R.C. § 170(c) (1982). Contributions to an organization qualifying under the "testing for public safety" category of § 501(c)(3) do not entitle the donor to a deduction. Similar provisions in § 2055 and § 2522 permit gift and estate tax deductions for transfers to qualifying organizations. Deduction status is usually the most important advantage of tax-exempt status because it is a valuable fund-raising edge.

17. I.R.C. §§ 3101-3126 (1976 & Supp. V 1981) (FICA).

18. I.R.C. §§ 3301-3311 (1976 & Supp. V 1981) (FUTA). The exemption from payroll taxes is also a major advantage. In *Bob Jones* more than $490,000.00 in disputed taxes were payroll taxes assessed after the school's tax-exempt status was revoked. *See infra* text accompanying notes 38-41.

19. The purpose of the university, as stated in its certificate of incorporation is as follows: "The general nature and object of the corporation shall be to conduct an institution of learning for the general education of youth in the essentials of culture and in the arts and sciences, giving special emphasis to the Christian religion and the ethics revealed in the Holy Scriptures . . . ." Bob Jones Univ. v. United States, 468 F. Supp. 890, 893 (D.S.C. 1978), *rev'd*, 639 F.2d 147 (4th Cir. 1980), *aff'd*, 103 S. Ct. 2017 (1983).

20. The following are two examples of the rules governing campus life: "Students are asked to refrain from singing, playing, and as far as possible, from "tuning in" on the radio or playing on the record player jazz, rock-and-roll, folk rock, or any other types of questionable music." BOB JONES UNIVERSITY, STUDENT HANDBOOK 13 (1975-76). "No young man may walk with a girl on the campus unless both of them have a legitimate reason for going in the same direction. Couples must not invent a reason to be going the same way; they both must be going the same direction for a definite purpose." *Id.* at 19.

21. 515 F.2d 1082 (4th Cir. 1975), *aff'd*, 427 U.S. 160 (1976).

university changed its admissions policy so that blacks no longer were excluded. The rules against interracial dating and marriage[22] remained in effect, however, in accordance with the school's belief that the Bible forbids interracial dating and marriage.

Prior to 1967 the IRS did not consider a private school's racial policies when deciding whether to grant tax-exempt status.[23] The first indication that this policy was changing came with the announcement that "exemption will be denied . . . if the operation of the school is on a segregated basis and its involvement with the state . . . is such as to make the operation unconstitutional or a violation of the laws of the United States."[24] Totally private schools not sufficiently involved with the state would still qualify as exempt organizations regardless of their admissions policies.[25]

In *Green v. Kennedy*[26] black Mississippi residents attacked the continued federal support through tax exemptions[27] of totally private segregated schools. A class action was instituted to enjoin the Secretary of the Treasury and the IRS from granting favorable tax rulings to private schools in Mississippi with racially discriminatory admissions policies. A three judge panel issued a preliminary injunction based on the substantial constitutional issue raised by the grant of tax-exemptions to discriminatory schools.[28] In the midst of this litigation, the IRS followed the lead of the court and announced that it could no longer legally justify granting tax-exempt status to discriminatory private schools.[29] After a hearing on the merits of the case,[30] the court reasoned that

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22. The rules against interracial dating and marriage are clear and comprehensive:

There is to be no interracial dating.

(1) Students who are partners in an interracial marriage will be expelled.

(2) Students who are members of or affiliated with any organization which holds as one of its goals or advocates interracial marriage will be expelled.

(3) Students who date outside of their own race will be expelled.

(4) Students who espouse, promote or encourage others to violate the University's dating rules and regulations will be expelled.

BOB JONES UNIVERSITY, STUDENT HANDBOOK 18 (1975-76).

23. Bob Jones College of Panama City, Florida, the predecessor of Bob Jones University, received tax-exempt status from the IRS in 1942 even though, at the time, the school refused admission to all black students. Appellee's Brief at 5, 13, Bob Jones Univ. v. United States, 639 F.2d 147 (4th Cir. 1980).

24. IRS News Release (Aug. 2, 1967), *reprinted in* 7 STAND. FED. TAX REP. (CCH) ¶ 6734 (1970).

25. If a segregated school was connected with a state, the operation would violate the holding in *Brown* that any state support is unconstitutional. *See, e.g.*, Cooper v. Aaron, 358 U.S. 1, 19 (1958) ("State support of segregated schools through any arrangement . . . cannot be squared" with its equal protection obligations). The IRS could not justify granting tax-exempt status to an illegal operation.

26. 309 F. Supp. 1127 (D.D.C.), *appeal dismissed sub nom.* Cannon v. Green, 398 U.S. 956 (1970).

27. *See supra* text accompanying notes 13-18.

28. *Green*, 309 F. Supp. at 1127. The court reasoned that the granting of tax exemptions and deductions to discriminatory schools was indirect federal support of these institutions. Since *Brown* held that the fourteenth amendment prohibited state support of these schools, indirect federal support is not permitted under the similar equal protection clause in the fifth amendment.

29. *See supra* note 4.

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

the Internal Revenue Code should not be construed to frustrate the national policy against segregation in education. To effectuate this aim the court restricted tax-exempt status to organizations meeting the terms of section 501(c)(3)[31] and required that the organization comply with public policy.[32] This interpretation obviated the need to address the constitutional questions[33] raised by a contrary reading of section 501(c)(3). Since the discriminatory private schools violated public policy, the court permanently restrained the grant of tax-exempt status to the organizations.

In 1970 the IRS explained to Bob Jones University its new policy concerning the grant of tax-exempt status and requested proof of nondiscriminatory policies. After concluding that the rules against interracial dating and marriage[34] coupled with the school's broad definition of a date[35] isolated black students from the mainstream of campus life,[36] the IRS proposed to revoke Bob Jones' tax exemption. The university responded by suing to enjoin the Service from revoking its tax-exempt status. The case culminated with the Supreme Court holding that the courts could not grant injunctive relief before the assessment or collection of any tax because Bob Jones could not show irreparable harm and certainty of success on the merits.[37]

On January 19, 1976, the IRS revoked the university's tax-exempt status retroactive to December 1, 1970.[38] The university, seeking a final resolution of the issue, filed payroll tax returns for the years 1970 through 1975[39] and immediately requested a refund of the $21.00 in taxes paid with the returns.[40] The IRS denied the request and the university brought suit in federal district court to recover the $21.00. The IRS counterclaimed for approximately $490,000.00 in payroll taxes plus interest.[41]

The district court held that the university was an exempt organization

31. *See supra* text accompanying note 11.

32. This interpretation was suggested as a statutory basis for denying tax benefits to discriminatory private schools in Comment, *supra* note 2, at 940-50. The general notion that an exempt organization must meet a national public policy test had existed much longer. *See* Reiling, *supra* note 12, at 529, 595.

33. *See supra* note 28.

34. *See supra* note 22.

35. Generally any association between male and female students other than incidental contact is considered a date. For example, walking with a student of the opposite sex is strictly controlled because this is considered an impermissible "date." *See supra* note 20.

36. Isolation from other students was recognized as a form of segregation and deemed unacceptable in McLaurin v. Oklahoma State Regents for Higher Educ., 339 U.S. 637 (1950).

37. Bob Jones Univ. v. Simon, 416 U.S. 725 (1974) (applying the anti-injunction section of the I.R.C., now codified at I.R.C. § 7421(a)).

38. Bob Jones University first was informed of the revised IRS policy in a letter dated December 1, 1970. Appellant's Brief at 202, Bob Jones Univ. v. United States, 639 F.2d 147 (4th Cir. 1980).

39. Revocation of tax-exempt status meant that staff salaries were no longer excluded from FICA and FUTA coverage. *See supra* notes 17-18 and accompanying text.

40. By filing the payroll tax returns and paying a small portion of the disputed taxes, the university removed the "assessment or collection of any tax" barrier to judicial review of the revocation. *See* Bob Jones Univ. v. Simon, 416 U.S. 725 (1974); *see also* text accompanying note 37.

41. Bob Jones Univ. v. United States, 468 F. Supp. 890, 893 (D.S.C. 1978), *rev'd*, 639 F.2d 147 (4th Cir. 1980), *aff'd*, 103 S. Ct. 2017 (1983).

under section 501(c)(3) and was entitled to a refund of the unemployment taxes.[42] Unlike the earlier *Green* decision,[43] the court employed a literal reading of section 501(c)(3). It rejected the contention that an exempt organization must comply with public policy as having no basis in the statute or the regulations promulgated under the statute.[44] On appeal, the Fourth Circuit Court of Appeals reversed, upholding the denial of tax-exempt status.[45] It cited with approval the requirement imposed in *Green* that the operation of an exempt organization must not be contrary to public policy and held that denial of tax-exempt status did not violate the university's first amendment rights.

The Supreme Court granted certiorari in *Bob Jones* and another case raising identical issues, *Goldsboro Christian Schools, Inc. v. United States*,[46] and affirmed the appellate courts' denial of tax-exempt status to both schools.[47] The Court agreed with the IRS view that "to qualify for a tax exemption pursuant to section 501(c)(3), an institution must show, first, that it falls within one of the eight categories expressly set forth in that section, and second, that its activity is not contrary to settled public policy."[48] This interpretation, the Court said, was mandated by several considerations.

First, the Court noted that a broad reading of any statute was justified when reliance on the literal language would defeat its plain purpose. In Internal Revenue Code section 170, Congress defined the broad category of "charitable contributions" as gifts to the same organizations as those listed in section 501(c)(3).[49] The Court reasoned that the use of identical language in the two sections revealed that Congress, in section 501(c)(3), intended to confer favorable tax benefits on section 170 charitable organizations.[50] To refine its definition of charitable, the Court attempted to discern congressional intent in exempting such charities. When tax exemptions first became a part of the revenue laws, there existed a significant body of common law concerning charitable trusts. From this fact the Court determined that Congress merely intended to extend tax-exempt status to charities meeting the common-law standards. At common law, only charitable uses consistent with public policy were upheld.[51] Thus, the Court reasoned that this restriction became an unwritten part of the exemption statute.[52] Since "every pronouncement of this Court

42. *Id.* at 907.

43. *See supra* text accompanying notes 30-33.

44. Neither the language of I.R.C. § 501(c)(3) (1982), *see supra* text accompanying note 11, nor the regulations, *see infra* note 68, expressly denies an exemption to a discriminatory educational or religious institution.

45. Bob Jones Univ. v. United States, 639 F.2d 147 (4th Cir. 1980), *aff'd*, 103 S. Ct. 2017 (1983).

46. 436 F. Supp. 1314 (E.D.N.C. 1977), *aff'd mem.*, 644 F.2d 879 (4th Cir. 1981), *aff'd*, 103 S. Ct. 2017 (1983) (also a private religious school maintaining a racially discriminatory admissions policy based on religious beliefs).

47. *Bob Jones*, 103 S. Ct. at 2036.

48. *Id.* at 2025.

49. I.R.C. §§ 170(c), 501(c)(3) (1982).

50. *Bob Jones*, 103 S. Ct. at 2026.

51. *Id.* at 2026-28.

52. *Id.* at 2028-29. In his dissenting opinion, Justice Rehnquist's central point of disagree-

and myriad Acts of Congress and Executive Orders attest a firm national policy to prohibit racial segregation and discrimination in public education,"[53] the Court refused to sustain an exemption in conflict with this policy.[54]

The university argued that the imposition of a public policy requirement in addition to the terms of section 501(c)(3) was a congressionally unauthorized broadening of the statute.[55] The Court rejected this argument, stating that Congress gave the IRS extensive authority to administer the tax laws and that the Service simply was exercising that authority to meet changed conditions.[56] Even if the IRS had overstepped its authority, the Court determined that congressional inaction since the new interpretation was announced in 1970[57] indicated that the IRS had correctly interpreted section 501(c)(3). Otherwise, Congress surely would have taken steps to correct the error before allowing twelve years to pass. Thus, by not acting when it must have been acutely aware of the issue,[58] Congress was deemed to have ratified "by implication . . . the 1970 and 1971 rulings."[59]

The Court concluded by holding that the denial of tax-exempt status did not violate the university's first amendment right to free exercise of its religious beliefs.[60] The free exercise right is not "an absolute prohibition against governmental regulation of religious beliefs."[61] If the government interest against a practice is strong enough to outweigh the intrusion, the regulation will be permitted.[62] Since the government interest against segregation was so compelling and the invasion did not prevent the exercise of the school's religious beliefs, the Court upheld the constitutionality of denying tax-exempt status even though the segregation was the result of a religious belief.[63]

By recognizing an interpretation of section 501(c)(3) that included an additional public policy requirement, the Supreme Court foreclosed any balancing of the free exercise rights of the first amendment with the equal protection guarantees of the fifth amendment.[64] Admittedly, this interpretation was consonant with the presumption in favor of a statutory construction that avoids

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ment was with the broad reading of § 501(c)(3) employed by the majority. *Id.* at 2040-42 (Rehnquist, J., dissenting).

53. *Id.* at 2029.

54. *Id.* at 2030-31.

55. *Id.* at 2031.

56. *Id.* at 2031-32.

57. Rev. Rul. 447, 1971-2 C.B. 230. *See supra* note 4.

58. Numerous bills were introduced in Congress to overturn the IRS interpretation. *See Bob Jones*, 103 S. Ct. at 2033 n.25. Also, Congress had affirmatively acted to overturn a contrary reading of § 501(c)(7). *See Bob Jones*, 103 S. Ct. at 2033 n.26.

59. *Bob Jones*, 103 S. Ct. at 2033.

60. *Id.* at 2034-35.

61. *Id.* at 2034.

62. *See, e.g.*, Wisconsin v. Yoder, 406 U.S. 205, 220 (1972) ("[A]ctivities of individuals, even when religiously based, are often subject to regulation by the States . . . .").

63. *Bob Jones*, 103 S. Ct. at 2035. For a discussion of the constitutional issues in *Bob Jones*, see Note, *Constitutional Law—Religious Schools, Public Policy, and the Constitution:* Bob Jones University v. United States, 62 N.C.L. REV. 1051 (1984).

64. *See supra* note 7.

constitutional difficulties.[65] The language of section 501(c)(3), however, is clear; the consequences of injecting public policy into statutory construction and vesting the policy decision in an administrative agency demand a closer examination of the analysis in this case.

Neither the language of section 501(c)(3) nor the regulations promulgated thereunder support the imposition of an additional public policy requirement upon exempt organizations.[66] Unfortunately, the Court gave little weight to the statutory language in adopting the revised interpretation as the correct one. In section 501(c)(3) the word "charitable" is not used as an inclusive term for all exempt organizations followed by a listing of examples of such organizations. Rather it was placed among seven other terms describing distinct purposes for which exemptions could be granted. The IRS, in formulating its interpretation of the statute, found this fact particularly important.[67] The regulations promulgated under section 501(c)(3) emphasize that the enumerated categories are discrete. Treasury Regulations provide a separate definition for each exempt purpose,[68] and there is no provision in the regulations imposing a charitable requirement upon each purpose. The "charitable" category is given a broad definition so that organizations not qualifying under other exempt purposes may still gain exempt status.

The Court, by construing the statute to require that an exempt organization pass a public policy test, is rewriting an old statute to make it conform to modern conditions. The Court has refused to take this approach in the past, stating that to do so is to impermissibly invade the province of Congress.[69]

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65. See the discussion of this presumption in U.S. COMMISSION ON CIVIL RIGHTS, DISCRIMINATORY RELIGIOUS SCHOOLS AND TAX EXEMPT STATUS 17 (1982).

66. *See* Neuberger & Crumplar, *Tax Exempt Religious Schools Under Attack: Conflicting Goals of Religious Freedom and Racial Integration,* 48 FORDHAM L. REV. 229, 238-40 (1979).

67. I.T. 1800, II-2 C.B. 152, 153 (1923) states:

> It seems obvious that the intent must have been to use the word "charitable" in section [501(c)(3)] in its more restricted and common meaning and not to include either religious, scientific, literary, educational, civic or social welfare organizations. Otherwise, the word "charitable" would have been used by itself as an all-inclusive term, for in its broadest sense it includes all of the specific purposes enumerated. That the word "charitable" was used in a restricted sense is also shown from its position in the section.

68. For instance, Treas. Reg. § 1.501(c)(3)-1(d)(3)(i) (1959) provides:

> The term "educational," as used in section 501(c)(3), relates to—
>
> (a) The instruction or training of the individual for the purpose of improving or developing his capabilities; or
>
> (b) The instruction of the public on subjects useful to the individual and beneficial to the community . . . .

Treas. Reg. § 1.501(c)(3)-1(d)(3)(ii) (1959) gives examples of exempt educational organizations:

> An organization, such as a primary or secondary school, a college, or a professional or trade 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.

69. *See, e.g.*, Mobil Oil Corp. v. Higginbotham, 436 U.S. 618 (1978). Explaining the Court's reason for not allowing recovery for loss of society under the Death on the High Seas Act even though recovery would have been allowed if the wrongful death had occured in territorial waters, Justice Stevens wrote:

> There is a basic difference between filling a gap left by Congress' silence and rewriting rules that Congress has affirmatively and specifically enacted. In the area covered by the statute, it would be no more appropriate to prescribe a different measure of damages

Whether the courts will encounter other statutes rendered anachronistic by changes in social attitudes, yet not amended by Congress to reflect the changes, remains to be seen. By demonstrating its willingness to substitute a revised meaning for such a statute, however, the Court now will have to consider the significance of the changes when previously the issue could be dismissed as a matter for Congress. Such a practice puts the Court in an unauthorized legislative position and may even encourage challenging statutes solely on policy grounds after efforts for repeal or amendment have failed.

The Court implied that the additional public policy requirement constituted an administrative change in the law when first announced[70] by stating that twelve years of congressional inaction since the IRS's policy change represents acquiescence and ratification.[71] Here again, however, the Court engaged in conduct it had disavowed in the past:

> The power of an administrative officer or board to administer a federal statute and to prescribe rules and regulations to that end is not the power to make law—for no such power can be delegated by Congress—but the power to adopt regulations to carry into effect the will of Congress as expressed by statute. . . . The regulation constitutes only a step in the administrative process. It does not, and could not, alter the statute.[72]

Supporting an administrative change in the law makes the Court vulnerable to criticism that it is encouraging the delegation of congressional responsibility to administrative agencies. Delegation is recognized as necessary when the substantive areas under consideration demand technical expertise. But when the issue is a pure policy matter, such as that in *Bob Jones* (governmental support of racial discrimination on religious grounds), delegation is undesirable because the decisionmaker receives little input from the public and is not accountable directly to the electorate. Congress has the constitutional responsibility to make basic decisions of policy, and the judiciary should not support an abdication of this duty.[73]

By judicially recognizing a change in the law made by an administrative agency the Court has created additional problems. The result in *Bob Jones* may influence the direction the executive branch will take to amend a law in the future. A situation may arise in which an executive branch, frustrated by the increasing tendency toward congressional inaction, may direct a change in agency regulations even though the change is not authorized by the language

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than to prescribe a different statute of limitations, or a different class of beneficiaries. Perhaps the wisdom we possess today would enable us to do a better job . . . but . . . we have no authority to substitute our views for those expressed by Congress in a duly enacted statute.

Id. at 625-26.

70. *See supra* note 4.

71. *See supra* text accompanying notes 57-59.

72. Manhattan Gen. Equip. Co. v. Commissioner, 297 U.S. 129, 134-35 (1935), *cited in* Ernst & Ernst v. Hochfelder, 425 U.S. 185, 213-14 (1976) *and* Dixon v. United States, 381 U.S. 68, 74-75 (1965).

73. *See generally* J. FREEDMAN, CRISIS AND LEGITIMACY: THE ADMINISTRATIVE PROCESS AND AMERICAN GOVERNMENT 78-80, 93-94 (1978).

of the statute. In a suit challenging the change after a further period of congressional inaction, a court may be forced to decide whether the inaction ratified the change. This practice deprives the issue of debate by the officials elected for the purpose.[74]

The Court in *Bob Jones* further supported its interpretation of section 501(c)(3) by relying on a long-standing presumption against statutory constructions that encourage the violation of public policy. This policy was first employed in *Tank Truck Rentals, Inc. v. Commissioner*[75] in which the Court disallowed the deduction of fines imposed for violating state maximum truck weight statutes. The Court stated that the test for disallowance is "the severity and immediacy of the frustration resulting from allowance of the deduction";[76] the greater the frustration of an established policy the more likely the disallowance of a deduction. In *Tank Truck* the frustration of the explicit state statutory policy against overweight trucks was severe because allowing a deduction for the fine imposed would reduce the deterrent effect of the penalty.

Once the Court expressed its willingness to deny deductions based on public policy, the inquiry became common in tax litigation.[77] The proliferation of cases raising the public policy question did not escape the Supreme Court's notice. In *Commissioner v. Tellier*[78] the Court reiterated the need for a close relation between the deduction and the frustration of public policy and indicated that it would be unwilling to extend the doctrine to situations other than those already recognized.[79] Congress codified all of the recognized public policy exceptions in the Tax Reform Act of 1969,[80] and the regulations promulgated thereunder reflect the desire to limit the doctrine to the codified provisions.[81] The Senate Finance Committee indicated its similar desire:

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74. Debate by elected officials ensures diverse viewpoints on every issue. In legal actions debate is limited to specific facts and usually represents only two viewpoints. Laws, being applicable to everyone, should be made in the former context to guarantee relevancy and fairness. *See generally* Panama Refining Co. v. Ryan, 293 U.S. 388 (1935); Wright, *Beyond Discretionary Justice*, 81 YALE L.J. 575 (1972).

75. 356 U.S. 30 (1958).

76. *Id.* at 35.

77. *See, e.g.*, Hoover Motor Express Co. v. United States, 356 U.S. 38 (1958); Sullivan v. Commissioner, 356 U.S. 27 (1958). For an analysis of the public policy doctrine in statutory construction and its popularity at the time see Comment, *Business Expenses, Disallowance, and Public Policy: Some Problems of Sanctioning with the Internal Revenue Code*, 72 YALE L.J. 108 (1962); Note, *Deduction of Business Expenses: Illegality and Public Policy,* 54 HARV. L. REV. 852 (1941); Annot., 27 A.L.R.2D 498 (1953).

78. 383 U.S. 687 (1966).

79. "[I]t is only in extremely limited circumstances that the Court has countenanced exceptions to the general principle reflected in the *Sullivan*, *Lilly*, and *Heininger* decisions." *Id.* at 693-94. The cases cited stand for the general principle that a deduction will be allowed if there is some business purpose notwithstanding questions regarding the frustration of policy raised by allowing the deduction. In Lilly v. Commissioner, 343 U.S. 90 (1952), a deduction was allowed for kickback payments made by opticians to the prescribing doctor of one-third of the retail price of the cost of eyeglasses. In Sullivan v. Commissioner, 356 U.S. 27 (1958) and Commissioner v. Heininger, 320 U.S. 467 (1943), a deduction was allowed for the cost of defending criminal charges arising out of the taxpayers' business.

80. The exceptions are codified in I.R.C. §§ 162(c), (f), (g) (1982). These provisions disallow the deduction of illegal bribes, payments of fines or penalties, and treble damage payments under the antitrust laws.

81. Treas. Reg. § 1.162-1(a) (1983) provides:

"The provision for the denial of the deduction for payments in these situations which are deemed to violate public policy is intended to be all inclusive."[82] Yet, in *Bob Jones* the Court ignored these limitations and extended the doctrine beyond the specific instances codified by the 1969 Act. Because the Court used this doctrine to justify its interpretation of section 501(c)(3), the issue may again become prominent in tax litigation, casting the IRS and the courts in the role of public policy arbitrators. This role should be reserved strictly for Congress.[83]

In addition to the potential increase in cases demanding public policy scrutiny and the conflict with an explicit desire to limit the public policy doctrine, there are fundamental questions whether the doctrine even applies to *Bob Jones*. In *Tank Truck* and *Tellier* the Supreme Court held that there must be a strong correlation between the support of the act and the frustration of the public policy. The district court in *Bob Jones* found that the university's position against interracial dating and marriage is the product of a sincere religious belief.[84] It is likely, therefore, that the university would continue the policies regardless of its tax status. Thus, the correlation between tax-exempt status and segregation in this instance was significantly weaker than in *Tank Truck*. Moreover, the policy violated in *Bob Jones* differs significantly from that in *Tank Truck*. In *Tank Truck* the taxpayer was denied a deduction for a penalty imposed because an explicit statute was violated. Bob Jones University was denied tax-exempt status not for breaking a law but for violating a social policy. Construing the tax laws to preserve the deterrent effect of a separately enacted statute, as in *Tank Truck*, is quite different from construing the tax laws as punitive statutes to effect social policy. The latter practice takes the tax code beyond its original purposes of revenue producer and economic policy vehicle. The Supreme Court recognized this distinction in *Lilly v. Commissioner*,[85] in which the Court refused to deny a deduction for kickback payments made by opticians to the prescribing doctor. The Court stated that while the practice may be socially unacceptable it did not violate any federal or state statutes. A more thorough consideration of the weak correlation between the school's policies and exempt status as well as the difference in factual settings might have persuaded the Court to refuse to invoke the public policy doctrine in *Bob Jones*. The Court's preoccupation with the strong governmental interest against racial discrimination, however, prevented an unbiased analysis.

By vesting the choice of how to further a public policy through the use of alternative statutory interpretations in an administrative agency, the *Bob*

A deduction for an expense paid or incurred after December 30, 1969, which would otherwise be allowable under section 162 shall not be denied on the grounds that allowance of such deduction would frustrate a sharply defined public policy. See Section 162(c), (f), and (g) and the regulations thereunder.

82. S. REP. No. 552, 91st Cong., 1st Sess. 273-75, *reprinted in* 1969 U.S. CODE CONG. & AD. NEWS 2027, 2311.

83. *See supra* note 73 and accompanying text.

84. *Bob Jones*, 468 F. Supp. at 890.

85. 343 U.S. 90 (1952).

Jones decision generates additional problems. If an organization violates a policy less sharply defined than the one against racial discrimination, the IRS should not be responsible for determining how the policy will be effected. Its expertise is in the collection of revenue, not in making broad policy decisions. The *Bob Jones* approach places a delicate decision in the hands of an agency only indirectly answerable to the electorate. It deprives taxpayers of the opportunity to present their side of the issue to a legislative body before the agency acts to enforce the policy. Reserving these matters solely for congressional consideration would alleviate these concerns and is more in keeping with the structure of our system of government.

This problem is particularly acute because public policy is constantly changing. Bob Jones University received a favorable determination letter from the IRS in 1942.[86] Since that time, the school had operated in essentially the same manner, yet a change in policy left the university with a large tax deficiency. Although the university was notified before the tax deficit accrued, the treasury regulations state that "so long as there are no substantial changes in the organization's character, purposes, or methods of operation"[87] the organization may rely on a prior determination of its tax-exempt status. The district court saw this as an unacceptable change in the law without the action of Congress,[88] but the Supreme Court held that the present interpretation was always the law or that the prior interpretation was erroneous. Allowing the tax laws to change with public policy places a tremendous burden on the taxpayer. After *Bob Jones*, exempt organizations will have to anticipate shifts in policy and adjust their operations accordingly, because they can no longer rely on the statute as applied in the past.

The Supreme Court in *Bob Jones* repeatedly stressed the importance of the government's interest in prohibiting racial discrimination. Yet by imposing an additional public policy requirement on exempt organizations as an *unwritten* part of section 501(c)(3), the Court more than likely has foreclosed any congressional action toward a permanent amendment of the statute. Consequently, enforcement is left to the discretion of the IRS. The Treasury Department's announcement that the IRS would no longer revoke or deny tax-exempt status to organizations that do not conform to certain policies[89] emphasized the danger of a reversal of the revised policy. Only strong public reaction[90] kept the announced action from being implemented.[91] An explicit prohibition against government support of discrimination in education needs

86. *See supra* note 23.

87. Treas. Reg. § 1.501(a)-1(a)(2) (1960) (amended 1976 & 1982).

88. *Bob Jones*, 468 F. Supp. at 905.

89. Treas. Dept. News Release (Jan. 8, 1982), *reprinted in* 10 STAND. FED. TAX REP. (CCH) ¶ 6301 (1982). *See also* Taylor, *U.S. Drops Rule on Tax Penalty for Racial Bias*, N.Y. Times, Jan. 9, 1982, § 1, at 1, col. 2.

90. Washington Post, Jan. 12, 1982, at A16, col. 1; Washington Post, Jan. 15, 1982, at A14, col. 3; *Pirouetting on Civil Rights: Reagan Goes Round and Round on Tax Breaks for Schools,* TIME, Jan. 25, 1982, at 24.

91. Treas. Dept. News Release (Jan. 18, 1982), *reprinted in* 10 STAND. FED. TAX REP. (CCH) ¶ 6315 (1982).

codification so that strong public reaction will not have to be relied on to police administrative enforcement of statutes involving important policy issues. Reserving the matter for Congress would have forced such a codification in section 501(c)(3) that could not be reversed by the executive branch through an administrative agency.

The Supreme Court encountered one of the most controversial issues in recent years in *Bob Jones*.[92] The civil rights movement has come too far for the United States government to encourage attempts by some to turn back time to the days of racial discrimination. But justification for denying tax exemptions to discriminatory organizations does not exist in the present statutory framework. The Court had other alternatives. The practice of granting exemptions to discriminatory organizations could have been reserved as a matter for Congress. Certainly, a policy as important as the one against racial discrimination deserves codification. Although less viable, the Court could have declared the practice unconstitutional.[93] By choosing the most expedient solution to the problem, the Court demonstrated that it is still willing to be the leader in advancing civil rights. Given the problems created in the area of statutory construction by this leadership, the Court should consider surrendering this role to Congress.

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92. *See Bob Jones*, 103 S. Ct. at 2030: "Few social or political issues in our history have been more vigorously debated and more extensively ventilated than the issue of racial discrimination, particularly in education."

93. *See id.* at 2045 n.45 (Rehnquist, J., dissenting) (stating that a facially neutral statute such as § 501(c)(3) is not government action in support of segregation and therefore not a violation of equal protection of the law).