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FEDERAL TAX EXEMPTION FOR PRIVATE SEGREGATED SCHOOLS: THE CRUMBLING FOUNDATION

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Graduates of Wade Hampton Academy in Orangeburg, South Carolina, receive a bronze lapel pin as an emblem of their alma mater which is a replica of one worn during Reconstruction. Beneath a Confederate flag, the pin bears the legend, "Survivor." [1] The symbol is appropriate to Wade Hampton as well as to scores of other private segregated schools, which have recently risen in the South as a last attempt to turn the flank of *Brown v. Board of Education*.[2]

Unlike similar academies in other southern states, Wade Hampton owes nothing for its "survival" to tuition subsidy from state government sources. A single payment was made under a South Carolina statute before it was ruled unconstitutional, and further payments were enjoined.[3] Yet, ironically, this school and many of its type must credit their survival, in part at least, to the federal government. Consciously, deliberately, and against continual objection, the Internal Revenue Service has approved exemptions for private, racially segregated schools under the charitable sections of the Internal Revenue Code, thus sharing the costs of developing them. According to the current Commissioner, the policy provoked "a series of studies that have gone on almost constantly since late 1959." [4] Letter rulings were issued routinely, then suspended, then continued under a cryptic restatement of policy.

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1. *See* Leeson, *Private Schools for Whites Face Some Hurdles*, 3 SOUTHERN ED. REP., Nov. 1967, at 13.

2. 347 U.S. 483 (1954).

3. Leeson, *supra* note 1.

4. Official Transcript of Commissioner Randolph W. Thrower's News Conference on the Tax Exempt Status of Private Schools (July 10, 1970).

In July 1970, the Service, threatened with an injunction, reversed its policy and announced that it would revoke and deny exemptions to private schools unwilling to follow a publicly announced nondiscriminatory admissions policy.[5] The Commissioner explained: "This is a statement of a position which the administration thinks is correct, which it will seek to maintain and uphold in court, but which has not been acted upon by the United States Supreme Court and is a question that has to be resolved." [6] He did not choose to clarify the legal basis for interpreting the charitable sections of the Code to preclude exemptions for private, segregated schools, and he avoided comment on the rules which the Service would adopt to implement its policy, insisting that the specific procedure would evolve from experience. This article examines the basic issue which the Commissioner and the Service have failed to clarify, the policy and doctrine underlying the conflicting postures of the federal government on tax exemption of private, segregated schools.

The Charitable Sections of the Internal Revenue Code

It is helpful to begin the discussion with a review of the charitable sections of the Code which will provide a frame of reference for this article. The Internal Revenue Code of 1954, section 170(c)(2) allows an individual to deduct from his adjusted gross income contributions to a "corporation, trust, . . . or foundation . . . organized and operated exclusively for religious, charitable, scientific, literary, or educational purposes or for the prevention of cruelty to children or animals." Section 170(c)(2)(C) provides, however, that no part of the net earnings of any such organization may inure to the benefit of any private shareholder or individual. Section 170(c)(2)(D) provides further that eligible organizations must refrain from lobbying and other efforts to influence legislation. "Educational organizations" are given an added status by section 170(b)(A)(ii). It raises from 20 percent to 30 percent the maximum percentage of adjusted gross income subject to offset by charitable deductions. For purposes of section 170(b) an "educational organization" is defined by section 503(b)(2) as one "which normally maintains a regular faculty and curriculum and normally has a regularly enrolled body of pupils or students in attendance at the place where its educational activities are carried on."

5. *Id.*
6. *Id.*

Section 501(c)(3) exempts from federal tax the income of "[c]orporations . . . organized and operated exclusively for religious, charitable, scientific, testing for public safety, literary or educational purposes . . . ." The remaining provisions of section 501(c)(3) are much the same as those of section 170(c).

Besides the income tax deduction for charitable contributions granted by section 170, section 2522 exempts the donor from gift tax on such contributions and section 2055 provides that charitable bequests may be deducted from the taxable estate in computing federal estate tax. Both sections are practically the same as sections 170(c) and 501(c)(3) in their terms and provisions.

Contributions made to a school classified as tax exempt entitle the donor to take a deduction from his taxable income. A donor who provides a building or land for a school site, if the basis of his property is below market value, may deduct the current market value without realizing capital gain. A wealthy donor who has used up his $60,000 lifetime tax exemption can avoid the payment of a gift tax (if the gift exceeds $3000), and take a charitable deduction instead. He, like the donor of low basis property, escapes one federal tax and reduces another.[7]

Benefits of Tax Exemption to Private Schools

The extent to which deductibility actually induces donations is disputed by specialists in the tax field. Private school promoters appear to believe, however, that the tax deductible feature is an attractive incentive. An advertisement once used by John T. Morgan Academy of Selma, Alabama, reflects this belief:

> Giving Can Be Generous, Yet Frugal Contributions by individuals or corporations to a qualified not-for-profit institution (such as the Dallas County Private School Foundation) are deductible up to 30% of the individual's Adjusted Gross Income and up to 5% of the corporation's net income. Unusual savings may be realized by contributing stocks, bonds, or other capital assets which have increased in value since acquired, instead of selling the securities and contributing the proceeds.[8]

7. *See generally* B. Bittker, Federal Income, Estate, and Gift Taxation (3d ed. 1964).

8. United States Commission on Civil Rights, Southern School Desegregation—1966-67 at 157 n.52 (1967).

Shortly before the Commissioner's July 1970 announcement,[9] a Mississippi school official conceded that without tax exemption private schools would be "badly hurt," and acknowledged that a denial of exemption "could imperil many schools on marginal budgets." [10] In other words, if donations are insufficient to finance a school plant, they may, nevertheless, make the marginal difference in operating funds enabling the school to carry on in improvised quarters, or provide enough equity to make mortgage financing feasible. If its property is encumbered, the school will probably find it necessary to apply any net income to amortize its mortgage debt. An exemption alone may not lead to financial salvation, but if there is taxable income, the exemption may save the school a significant percentage of its net income. This income which would otherwise be paid in taxes may instead be used to retire mortgage debts and acquire equity in a permanent school plant.

In Alabama, the Civil Rights Commission investigated the financing of three private, segregated schools, and found in each case a significant disparity between tuition revenues and operating and construction costs. Without donations, the schools would have sustained heavy deficits.[11] In *Coffey v. Mississippi*,[12] in which a federal court held unconstitutional the Mississippi tuition-grant statute, the government prepared a summary chart on the operation of private, segregated schools in Mississippi. The data compiled showed that a number of schools relied significantly on contributions, even with a program of tuition subsidy in effect. Without tuition grants, these schools presumably would have been even more dependent on private contributions.

The government data in *Coffey* also demonstrated the relationship between the newly formed segregated schools and the public school system, showing a direct correlation between public school integration and the rise of private schools. With the loss of white students, most public schools lose state financial support, which is normally allotted on a per student basis. The exodus of white students threatens the loss of economies of scale that the school system might have enjoyed before. In short, while allotment funds decline, the cost of education

9. Official Transcript, *supra* note 4.

10. *Tax Report: Segregated Schools in the South Look to the Churches for Sanctuary*, The Wall Street Journal, May 27, 1970, at 1, col. 5.

11. Parker, *Federal Boost for Segregation*, 1 CIVIL RIGHTS DIGEST, Fall, 1968, at 24. *See also* UNITED STATES COMMISSION ON CIVIL RIGHTS, *supra* note 8, at 74-75.

12. Coffey v. Mississippi State Educ. Fin. Comm'n, 296 F. Supp. 1389 (S.D. Miss. 1969).

per student rises. Raising tax levies or issuing bonds for the public school system becomes politically onerous, as the experience of Nottoway County, Virginia illustrates.

> School officials in Nottoway County, Virginia, reportedly had difficulty encouraging voter approval of a $1.6 million bond issue in 1967 to finance public school development. White citizens had virtually no interest in the public system; more than 300 white children had escaped impending desegregation of public schools by enrolling in private schools. In a statewide private school fund drive, however, the same county topped all other Virginia counties in raising money.[13]

In *Poindexter v. Louisiana Financial Assistance Commission*[14] a panel from the fifth circuit surveyed the burgeoning system of private schools in Louisiana and spelled out the threat categorically:

> The facts this case presents point in only one direction: Unless this system is destroyed, it will shatter to bits the public school system of Louisiana and kill the hope that now exists for equal educational opportunities for all our citizens, black and white.[15]

The IRS Rulings on Private Segregated Schools

In the summer of 1967, the Civil Rights Commission published a progress report on the past school year.[16] The report deprecated the grant of tax exemption to private, segregated schools:

> Many private segregated schools attended exclusively by white students have been established in the South in response to public school desegregation. In some districts such schools have drained from the public schools most or all of the white students and many white faculty members. Under the Internal Revenue Code of 1954, institutions organized and operated exclusively for charitable purposes and not for private benefit are exempt from paying income taxes and contributors to these institutions are entitled to deduct contributions, within certain limits, from their taxable incomes. Some racially segregated private schools have been approved by the Internal Revenue Service for the receipt of these tax

13. Parker, *supra* note 11, at 25.
14. 275 F. Supp. 833 (E.D. La. 1967).
15. *Id.* at 857.
16. United States Commission on Civil Rights, *supra* note 8.

> benefits, while others have applications pending before the Internal Revenue Service . . . . The benefits given racially segregated private schools by the grant of Federal tax benefits are extensive, and contribute to the growth and development of such schools. Contributions to these schools lessen the tax burdens of individual taxpayers, allow the schools to continue in operation, and diminish Federal revenues.[17]

On the basis of this finding, the Commission recommended that:

> The Secretary of the Treasury should request an opinion of the Attorney General as to whether Title VI of the Civil Rights Act of 1964 or the Internal Revenue Code authorizes or requires the Internal Revenue Code to withhold tax benefits presently being afforded by the Service to racially segregated private schools, or whether Congressional action is necessary to assure that such benefits are withheld . . . .[18]

The Commission added a memorandum prepared by its legal staff, elaborating the case against tax exemption for private, segregated schools.[19] Before publication of the report, the Office of General Counsel of the Civil Rights Commission sent a copy of this memorandum to its counterpart, the Chief Counsel of the Internal Revenue Service. Staff members of the IRS responded that they had a similar concern over such exemptions, and that they were then withholding action on forty-two applications for exemption, pending a review of applicable law.[20]

On August 2, 1967, the Internal Revenue Service reported its decision in a press release:

> The Internal Revenue Service announced today that it has resumed ruling on the tax exempt status of private, non-profit schools. This action marks the culmination of an extensive review of judicial and legislative developments in the civil rights area to determine the effect of these developments on qualification of schools for exemption for income tax purposes and their eligibility to receive deductible charitable contributions.
>
> In resuming ruling, the Service stated that its general con-

17. *Id.* at 89.
18. *Id.* at 99.
19. *Id.* Appendix VIII, at 142-62.
20. *Id.*

> clusion is that exemption will be denied and contributions will not be deductible 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 laws of the United States.
>
> Where, however, the school is private and does not have such degree of involvement with the political subdivision as has been determined by the courts to constitute State action for constitutional purposes, rulings will be issued holding the school exempt and the contributions to it deductible assuming that all other requirements of the statute are met.
>
> The Service emphasized that it will continue to watch carefully the legislative and judicial developments in the area of state action to determine whether the activities of any particular school render its operation illegal or unconstitutional and therefore disqualify it under 501(c)(3).[21]

In a more complete report in the *New York Times*, the Service explained that it intended to deny exemption to any school that was the direct recipient of state financial assistance.[22] This policy was required, the Service said, by *Aaron v. Cooper*.[23] "Revenue officials said that as they read that case, it renders illegal only direct payments by governmental units to private schools organized to evade segregation."[24] The Service explained that the cryptic reference to state-involvement was specifically a reference to *Griffin v. State Board of Education*,[25] in which Virginia tuition grants were held unconstitutional because they "predominantly maintained" private segregated schools.

Arguments against tax exemption for private segregated schools were not discussed in either the official release or the news report. The Civil Rights Commission had contended in its brief that private segregated schools do not meet the statutory standards of the charitable sections, and had further argued that tax exemption was tantamount to federal financial assistance and should be granted only under the conditions of Title VI of the Civil Rights Act of 1964.[26] The Commission had

21. Internal Revenue Service News Release (Aug. 2, 1967), 7 CCH 1967 STAND. FED. TAX REP., ¶ 6734.

22. N.Y. Times, Aug. 3, 1967, at 24, col. 3.

23. 257 F.2d 33 (8th Cir.), *aff'd*, 358 U.S. 1 (1958).

24. N.Y. Times, *supra* note 22.

25. 239 F. Supp. 560 (E.D. Va. 1965).

26. UNITED STATES COMMISSION ON CIVIL RIGHTS, *supra* note 8, Appendix VIII, at 142-62.

also suggested that under *Tank Truck Rentals, Inc. v. Commissioner*,[27] exemption should be denied on the grounds that a grant of exemption would tend to frustrate "sharply defined national policy." The IRS failed to answer any of these arguments. As the Commissioner noted at the time of his July 10, 1970 announcement, "The 1967 policy statement was rather inconclusive and in practical operation no adverse rulings were ever issued under it." [28]

In late 1969, Negro plaintiffs from Mississippi initiated a class action against the Secretary of the Treasury and the Commissioner of Internal Revenue to enjoin prospective exemptions and to rescind all existing exemptions of private, racially exclusive schools in Mississippi. A three-judge federal court was convened in the District of Columbia, and on January 12, 1970, the court issued a preliminary injunction restraining the Commission from "approving any pending or future application for tax exempt status . . . by any private school located in the State of Mississippi which enrolls students in any of the grades first through twelve . . . ." [29] The court granted the preliminary injunction as interlocutory relief, and in the course of its opinion indicated the probable nature of its final order. The complaint charged that sections 170 and 501 of the Code were unconstitutional to the extent that they supported the establishment and maintenance of private segregated schools. In the alternative, the complaint argued on non-constitutional grounds that segregated schools were not entitled to exemption under the tax code because they did not serve a public purpose. The court first found that the complaint raised a substantial constitutional question, warranting jurisdiction of a three-judge court. Citing from a sample of civil rights cases, the court then declared that the Fifth Amendment forbids the federal government from aiding private discrimination. It stopped short of the conclusion, however, that tax exemption of private, segregated schools was unconstitutional, resting its decision on the proposition that the federal government should not frustrate the efforts of state governments to adhere to the Constitution. "The Federal Government is not constitutionally free to frustrate the only constitutionally permissible state policy, of a unitary school system, by providing government support for endeavors to continue under private auspices the kind of racially segregated dual school system that the state formerly supported." [30]

27. 356 U.S. 30 (1958).
28. Official Transcript, *supra* note 4.
29. Green v. Kennedy, 309 F. Supp. 1127, 1140 (D. D.C. 1970).
30. *Id.* at 1137.

The court reserved judgment on the broader issue of a permanent mandatory injunction to revoke exemptions previously approved. A subsequent hearing on the merits was continued when government lawyers revealed that a change of policy was imminent and would be announced by the Service in a matter of days. Although some have argued that the Service's reversal in mid-July 1970 has made *Green v. Kennedy* moot, all sides have expressed interest in obtaining final judicial review.[31] It is probable, therefore, that the arguments first raised by the Civil Rights Commission[32] and later asserted in litigation will eventually be heard in court. With this probability in mind, it is appropriate that those arguments be examined.

THE LAW OF CHARITABLE TRUSTS AND THE CHARITABLE SECTIONS

In evaluating the arguments for and against exemption of private segregated schools, it is logical to begin with the policy of granting exemption that the Service first espoused and has now seemingly abandoned. On its face the tax code appears to support that policy. Read literally, the charitable sections of the Code exempt virtually any school —segregated or integrated, state-supported or privately maintained. This interpretation is the one which advocates of exemption for private schools have consistently espoused. It takes a curious subtlety to reach the conclusion the Service first upheld in 1967, to construe the Code as distinguishing "wholly private" from "state-involved" segregated schools, and to grant exemption to one while denying it to the other. Actually the IRS did not rely on a literal reading of the charitable sections to defend its exemption of segregated schools, but rather supported its policy as one developed in charitable trust law, which it viewed as a complement to the charitable sections of the Code.[33] In Revenue Ruling 67-325,[34] the IRS took the position that contributions to community recreational facilities would be deductible only if the facilities were open on a racially non-discriminatory basis. No distinction was drawn

31. *See* Christian Science Monitor, July 11, 1970, at 2, col. 2; N.Y. Times, July 11, 1970, at 1, col. 8.

32. UNITED STATES COMMISSION ON CIVIL RIGHTS, *supra* note 8.

33. *See* Reiling, *Federal Taxation: What is a Charitable Organization?*, 44 A.B.A. J. 525, 527 (1958). "If only the word *charitable* had been used, the exemption might have been misconstrued by taxpayers not familiar with the legal meaning given to that term, for charity in its popular sense is usually confined to good will to the poor and suffering." Reiling argues that all of the enumerations of INT. REV. CODE of 1954, § 501(c)(3) are in accord with the legal notion of charity.

34. 1967-2 CUM. BULL. 113.

between state-involved and privately endowed facilities; it was simply made a condition of tax exemption that a recreational facility admit everyone, regardless of race. On its face, the ruling was irreconcilable with the earlier decision on private school exemption.[35] As a way of explaining the ruling and, in effect, the apparent inconsistency, the Service referred to charitable trust law. It first broadly stated that there is no "specialized tax concept of charitable purposes, . . . [and the charitable sections] of the Code . . . should be interpreted as favoring only those purposes which are recognized as charitable in the generally accepted legal sense." [36] Applying this principle, the Service found that in the general law of charitable uses, "certain purposes have been deemed to be beneficial to the community as a whole even though the class or classes of possible beneficiaries eligible to receive a direct benefit . . . do not include all the members of the community." [37] Among these is a charitable trust to provide for education. A charity to provide recreation is to be distinguished and merits the favored legal treatment of a charity only when all members of the community are eligible to benefit from its use.

> In this body of general law pertaining to purposes considered charitable only where all members of the community are eligible to receive a direct benefit, no sound basis has been found for concluding that there would be an adequate charitable purpose if some part of the whole community is excluded from benefiting except where the exclusion is required by the nature or size of the facility. Exclusion of a part of the entire community on the basis of race, religion, nationality, belief, or other occupation having no relation to the nature or size of the facility, would prevent the purpose from being recognized as a sufficient public purpose to justify its being held charitable under this general body of law.[38]

Reading the charitable sections of the Code as an extension of the law of charitable trusts is not an innovation of the Internal Revenue Service. On close interpretative questions, federal courts have assumed that charitable trust law complements the charitable sections of the Code, at least by way of analogy.[39] In *Girard Trust Company v. Com-*

35. Internal Revenue Service News Release, *supra* note 21.

36. Rev. Rul. 67-325, 1967-2 CUM. BULL. 116.

37. *Id.* at 115.

38. *Id.* at 116.

39. *See, e.g.*, Pennsylvania Co. for Insurance v. Helvering, 66 F.2d 284 (D.C. Cir. 1933); Treas. Reg. §§ 1.501(c)(3), (d)(2).

missioner,[40] deciding whether a bequest to a Methodist temperance board was entitled to a charitable deduction, Judge Goodrich on his motion noted:

> Reference to the law of charitable trusts we believe in point, as does the dissent, although counsel for neither side has pressed the analogy . . . The majority of charitable trust cases . . . are not directly controlling. But they furnish a strong analogy.[41]

The syntax of the charitable sections does not compel this analogy. The word "charities" is only one adjective that follows "religious" and precedes "scientific" in describing the kinds of organizations that are exempt from federal taxation and eligible for deductible gifts. It is not uncommon, however, with a statute of broad terms, that a related body of common law becomes a source of reference. In terms and provisions, the relation of the charitable sections to charitable trust law is remarkably close. The organizations exempted by section 501(c)(3) virtually all conform to approved purposes for charitable trusts. Those that might be disputable in charitable trust law are arguably included in the Code for that very reason, to settle their status for federal tax purposes.[42] The tax code rule that none of the earnings of an exempt organization shall inure to the benefit of private shareholders is paralleled by an equivalent rule of charitable trusts.[43] Similarly, the provision in the Code restricting the political activity of exempt organizations is consistent with a tradition in the common law disfavoring charitable trusts with political purposes.[44]

If one reads sections 170(c) and 501(c)(3) as extensions of charitable trust law, "charitable" becomes the rubric of these sections and not just one of the kinds of organizations exempted. "Educational organizations," as it appears in these sections, is not read literally but as legal idiom. To elaborate on what the term implies, reference is made to the general law of charities—which essentially is the common law of charitable trusts that has grown out of the Elizabethan Statute of Charitable Uses.[45]

40. 122 F.2d 108 (3rd Cir. 1941).

41. *Id.* at 109-10.

42. *See* 4 A. Scott, The Law of Trusts § 374.2 (3rd ed. 1967). *E.g.*, societies for the prevention of cruelty to animals once were a topic of dispute in charitable trust law:

43. *Id.* § 368.

44. *Id.* § 374.6.

45. 43 Eliz. I, c. 4 (1601). *Discussed in* 4 A. Scott, *supra* note 42, § 368.1. *See*

In charitable trust law, any educational organization is considered charitable if the schooling or instruction is not for private profit and the class of students educated is sufficiently inclusive to be of benefit to the community. As to racial restrictions, Scott argues that so long as the class of students educated is broad enough to imply public benefit, restriction of the class along racial lines will not vitiate the trust.[46] Bogert once assumed the same position,[47] but he no longer appears willing to assert that racial restrictions are valid.[48] It is enough here to point out that the traditional law of charities has permitted educational trusts for the benefit of a racially defined class.

It was apparently this analogy to charitable trusts that the IRS applied in deciding that the Code permitted exemptions for private segregated schools. To summarize its reasoning: equity would sanction a charitable trust for the benefit of a school, even though the school discriminated racially among the students it accepted. Therefore, because the charitable sections of the Code are cut from the same cloth as charitable trust law, contributions to a private school should be tax deductible, and the school should be tax exempt, even though the school is racially segregated.

The 1967 news release on private segregated schools failed to make explicit this reasoning by analogy, but it is clearly the substance of Revenue Ruling 67-325.[49] More significantly, reports of the interagency debate before publication of the news release confirm that "[o]fficials of the Internal Revenue Service in discussions with the Commission on Civil Rights staff prior to the public announcement, maintained that *the traditional law of charities tolerated racial restrictions upon educational charities.*" [50]

Charitable trust law reduces to a doctrine of public benefit, and is one vehicle for putting a kind of public policy into the charitable sec-

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generally Atiyah, *Public Benefit in Charities*, 21 MODERN L. REV. 138 (1958); Brunyate, *The Legal Definition of Charity*, 61 L. Q. REV. 268 (1945).

46. 4 A. SCOTT, *supra* note 42, § 370.6.

47. In G. BOGERT, THE LAW OF TRUSTS AND TRUSTEES (2d ed. 1960), the author asserted unequivocally that racially restricted charitable trusts were permissible.

48. G. BOGERT, HANDBOOK OF THE LAW OF TRUSTS § 60 (4th ed. 1963). Bogert still allows that "[a] settlor may limit the class to be educated as he desires so long as some substantial social benefit will result, and if in the case of gifts to a state or an agency of it, he does not deprive persons of their constitutional rights to equal protection of the laws."

49. 1967-2 CUM. BULL. 116.

50. UNITED STATES COMMISSION ON CIVIL RIGHTS, *supra* note 8, Appendix VIII (emphasis added).

tions of the Code as a source of reference. If applied, an analogy to the law of charities nicely explains the paradox of ruling one month that private schools may be racially restrictive and still tax exempt,[51] while ruling the next month that recreational facilities must be open to the public without discrimination to merit tax exempt status.[52] It does not explain so readily why a "wholly" private school can discriminate without risking its charitable status, while a "state-involved" private school which discriminates is denied the grace of the Internal Revenue Code. To validate this distinction, one must carry the charitable trust analogy a step further. Applying the major premise that equity would deny its sanction to a charitable trust for an illegal purpose, and the minor premise that a "state-involved" private school operates illegally if segregated, the Service could draw the conclusion that "state-involved" private schools should be denied tax exempt status.

If this is the syllogism that was accepted, however, the distinction between the "wholly private" and the "state-involved" school is as illogical as ever. If the purpose of a segregated private school is considered educational, the added fact that the school is involved with the state appears merely incidental. The state-school relationship, coupled with the school's discrimination, may violate the Fourteenth Amendment; but the school's purpose is not any less educational because of this involvement. It is doubtful that a court of equity would consider a charitable trust for a school a trust for an illegal purpose if the school's location violated a zoning ordinance. Why, therefore, should equity consider the purpose of a private school illegal if its operation incidentally violates the Fourteenth Amendment? The Internal Revenue Service would have to respond that the state-involved private school is altogether—and not just incidentally—illegal, because it is a form of subterfuge by the state for avoiding the consequences of *Brown v. Board of Education*. This argument would be forceful, admittedly; but it would not obtain its force by analogy to charitable trust law. Resort to charitable trusts on this question leads merely to more ambiguity. There are no precedents, and an equity court might logically decide either way. It might consider the state-involved school an evasion of *Brown*, or it might pass over the potential violation of the Fourteenth Amendment as an "ancillary matter."

It would seem only proper for a court to choose the former course

51. Internal Revenue Service News Release, *supra* note 21.
52. Rev. Rul. 67-325, 1967-2 CUM. BULL. 116.

and bring *Brown* and related cases[53] into the law of educational charities. These cases, however, introduce policies and values incompatible with the doctrine that segregated education can benefit the public, and whose logical culmination is not disapproval of segregation in private schools involved with the state, but the denial of charitable status to all segregated schools. This is precisely the conclusion the IRS has resisted.

To support the logic of this conclusion, it is necessary to reconsider the basic statement that the law of charities tolerates racial restrictions upon educational charities. This reference to the law of charities belongs to what might be called the "categoric tradition" of charitable trusts. None of the cases and only a few of the commentators call it by this name; nevertheless, there is a trend running through some of the case law of charitable trusts that is biased towards more of a conceptual and less of an ad hoc approach. Essentially, this trend displays a penchant for categories of charitable purposes; and for the sake of discussion it will be called the "categoric tradition." [54]

At common law, a trust that would otherwise be void for violation of the rule against perpetuities or for designation of indefinite beneficiaries is valid if it meets the criteria of a charitable trust. The basic criterion is that the trust be established for public benefit, and the contribution of the categoric tradition is a two step formula for resolving this decision. The formula first presupposes categories of charitable purposes, which vary from case to case, but which usually merely restate Lord MacNaghten's classic statement of charitable purposes in *Pemsel v. Special Commissioners*.[55] MacNaghten declared that the common law growing out of the Elizabethan statute of charitable uses defined "four heads of charity": the relief of poverty, the advancement of religion, education, and miscellaneous purposes for the public good.[56] In the categoric tradition, this declaration has come not only to define the categories of charitable purposes, but to reflect an echelon among them. The relief of poverty, the original mode of charity, stands highest in the hierarchy, as the charitable purpose that most serves the public good. The class of beneficiaries of a trust for the poor, there-

53. Aaron v. Cooper, 257 F.2d 33 (8th Cir.), *aff'd*, 358 U.S. 1 (1958); Poindexter v. Louisiana, 275 F. Supp. 833 (E.D. La. 1967); Griffin v. State Bd. of Educ., 239 F. Supp. 560 (E.D. Va. 1965).

54. *See* Annot., 12 A.L.R.2d 849 (1950).

55. 3 British Tax Cases 53 (1891).

56. *Id.* at 96.

fore, can be confined rather narrowly, since, according to the second step of the categoric formula, the ranking of the trust purpose determines the permissible breadth of the beneficiary class. A trust for education stands somewhat lower in the hierarchy and, therefore, the class of beneficiaries must be broader than for a trust to relieve the poor. As for various undertakings outside the three established categories, they are presumed to be more dubiously related to the public good and, consequently, must serve a broad segment of the public to merit charitable trust treatment.[57]

It was this tradition of charitable trust law that the IRS drew upon in making its private school ruling and in issuing Revenue Ruling 67-325. The latter ruling, on recreational charities, was no doubt inspired by Mr. Justice White's concurrence in *Evans v. Newton*:[58]

> The first three categories identified by Lord MacNaghten designate trust purposes that have long been recognized as beneficial to the community as a whole—whether or not immediate benefit is restricted to a relatively small group . . . But the present trust (for a park) falls under the fourth category and can therefore be sustained as charitable only because the generality of user beneficiaries establishes that it is beneficial to the community.[59]

In *Baddeley v. Inland Revenue Comm.*,[60] Lord Somerwell advanced a similar opinion:

> I think that difficulties are apt to arise if one seeks to consider the class apart from the particular nature of the charitable purpose. They are in my opinion interdependent. There might well be a valid trust for the promotion of religion benefiting a very small class. It would not at all follow that a recreation ground for the exclusive use of the same class would be a charity.[61]

The categoric tradition is obviously a recurring thesis in charitable trusts. There is, however, a persistent antithesis. Much case-law is characterized by a very uncategorical, empirical attitude towards charitable trusts,[62] an approach that normally takes the form of sweeping

57. *See* 4 A. Scott, *supra* note 42, § 368; Atiyah, *supra* note 45.
58. 382 U.S. 296, 302 (1966).
59. *Id.* at 308.
60. [1955] A.C. 572. *See also* Atiyah, *supra* note 45.
61. [1955] A.C. 572, 615.
62. *See* Annot., 12 A.L.R.2d 849 (1950).

flourishes on the nature of charitable purposes. The statement of the Supreme Court in *Ould v. Washington Hospital for Foundlings*,[63] is a classic example:

> The great weight of opinion seems to be that a charitable trust which is neither against public law nor against public policy may be applied to anything that tends to promote the well-doing and well-being of social man.[64]

Authorities on charitable trusts not only acknowledge this rather undoctrinal approach, they regard it as the "ultimate law" of charitable trusts.[65] Scott, for example, follows the tradition of the established categories and accepts the *Pemsel* classification. He, nevertheless, refers also to a more general test: is the accomplishment of the trust purpose "of such social interest to the community as to justify permitting property to be devoted to the purpose in perpetuity?" [66] He clearly indicates that this latter test is the over-riding criterion.

English courts have manifested a similar attitude. Lord Normand in *Oppenheim v. Tobacco Securities Trust Co.*,[67] the principal English case on educational trusts, prefaced his opinion by remarking: "I remind your Lordships of the observations of Lord Simonds in *Gilmour v. Coats*,[68] that the law of charity has been built up not logically but empirically. It is this empirical development which has so baffled efforts to reduce the law to systematized definitions." [69] *Oppenheim* is in accord with English[70] and American cases[71] in its scrutiny of educational

63. 95 U.S. 303 (1877).

64. *Id.* at 309.

65. *See* Clark, *Charitable Trusts, the Fourteenth Amendment, and the Will of Stephen Girard*, 66 YALE LAW J. 979 (1957). "Purposes worthy of community support are diffuse as the winds. They vary with time . . . . Because of this constant flux, attempts to formalize the community benefit into abstract rules inevitably degenerate into a listing of *ad hoc* responses to particular situations." Id. at 997.

66. 4 A. SCOTT, *supra* note 42, § 368.

67. [1951] A.C. 297.

68. [1949] A.C. 426, 443.

69. [1951] A.C. 297, 309.

70. *In re* Shaw, [1957] 1 All E.R. 745, *noted in* 73 L. Q. REV. 305 (1957). George Bernard Shaw made a special bequest to underwrite research on a new English alphabet. The court held that the trust, despite its educational purpose, would not be of benefit to the community. The parties compromised in lieu of appeal, and the matter never reached the House of Lords.

71. *See, e.g.*, Wilber v. Asbury Park Nat'l Bank & Trust Co., 142 N.J. Eq. 99, 59 A.2d 570 (1948); Medical Soc. of South Carolina v. South Carolina Nat'l Bank, 197 S.C. 96, 14 S.E.2d 577 (1941). In *Wilber*, a testimentary trust to publish the writings

trusts and finding that public benefit was lacking. One authority notes that "[t]his new approach to charities does not mean that courts have abandoned their traditional favor towards charitable trusts. It simply means that the intrinsic merits of a proposed charity are issuable; and trusts are not to be upheld just because they come within a traditional category." [72] In short, the categoric tradition is one approach among several for determining the public benefit of a charitable trust.

Alternatively, a court might apply its own ad hoc, empirical judgment and dispense with *Pemsel* as defining something which by nature is inchoate. Or it might pay passing deference to the category of the trust, but delve into its merits. Either of these alternatives would meet the approval of the authorities. In the words of Bogert:

> The courts should be left free to apply the standards of the time on the theory that what may be charitable in one generation may be non-charitable in a later age, and vice versa. Ideas regarding social benefits and public good change from century to century and vary in different communities. It must expand with the advancement of civilization and the daily increased needs of man.[73]

Scott is in complete accord with this view, stating that "[t]he interests of the community . . . vary with time and place. Purposes which may be regarded as laudable at one time may be regarded as subserving no useful purpose or even as being illegal." [74]

Because of the ad hoc test and built-in assumption of change and growth, no recitation from the traditional law of charities alone can answer the question of whether the purpose of a trust is charitable. Charitable trust law is wedded to current values, and the traditional law yields to these values. An excellent example of the working of this rule is the treatment of recreational facilities.

> In Re MacDuff, [[1896] 2 ch. 451] among various instances of philanthropic but not charitable objects suggested by counsel and Court, two at least, public recreation grounds and an astrophysical

of the testator was held unenforceable because the writings were deemed of no value to the community. In the *Medical Society* case, the testator left her old home in Charleston as a museum, replete with its furnishings. The court found the proposed museum of little historic interest, and therefore of virtually no value to the community. *See also In re* Pinion, [1965] 1 Ch. 95.

72. Annot., 12 A.L.R.2d 849, 859 (1950).

73. 2 G. BOGERT, THE LAW OF TRUSTS AND TRUSTEES 1129 (1935).

74. 4 A. SCOTT, *supra* note 42, § 368, at 2630.

> observatory, are now unquestionably charities . . . . The reason is not so much a change in law as a change in knowledge, social consciousness, and social conditions.[75]

In recent years, the concept of education and public benefit has undergone a comparable "change in knowledge, social consciousness, and social conditions." Various authorities on trusts have asserted and sought to demonstrate that trusts providing for segregated schooling are inherently uncharitable, taking their cue from the Supreme Court in *Brown v. Board of Education:*

> To separate . . . [Negro students] from others of similar age and qualifications solely because of their race generates a feeling of inferiority as to their status in the community that may affect their minds and hearts in a way unlikely ever to be undone.[76]

The Civil Rights Commission in its report *Racial Isolation in Public Schools,*[77] emphasized that segregated education prevents white students from developing attitudes appropriate to an integrated society. The report of the National Advisory Commission on Civil Disorders[78] concurred in that report and continued:

> . . . [W]e believe school integration to be vital to the well-being of our society. We base this conclusion not on the effect of racial and economic segregation on the achievement of Negro students, although there is evidence of such a relationship; nor on the effect of racial isolation on the even more segregated white students, although the lack of opportunity to associate with persons of different ethnic and socio-economic backgrounds surely limits their learning experience. *We support integration as the priority education strategy because it is essential to the future of American society.* We have seen in this last summer's disorders the consequences of racial isolation, at all levels, and of attitudes towards race, on both sides, produced by three centuries of myth, ignorance, and bias. It is indispensable that the opportunities for interaction between the races be expanded. The problems of this

75. Brunyate, *supra* note 45, at 280.

76. 347 U.S. 483, 494 (1954).

77. UNITED STATES COMMISSION ON CIVIL RIGHTS, RACIAL ISOLATION IN PUBLIC SCHOOLS (1967).

78. REPORT OF NATIONAL ADVISORY COMMISSION ON CIVIL DISORDERS (New York Times ed. 1968).

> society will not be solved unless and until our children are brought into a common encounter and encouraged to forge a new and more viable design of life.[79]

If the principle of adaptive change built into charitable trusts were unresponsive to this development of informed sentiment, it would be difficult to understand the adage that charitable trusts comply "with the standards of the time." Courts in the past have approved or disapproved recreation grounds, temperance leagues, vivisection societies, and other purportedly charitable purposes primarily on a subjective definition of need, a standard which is virtually whimsical when compared to the case against segregated education.[80]

A basis for the argument that an educational trust can be racially restricted and still charitable is found in Restatement (Second) of Trusts:

> A trust to establish or maintain a school or other educational institution . . . is charitable although the beneficiaries are limited to those residing in a particular district or belonging to a particular class, provided that the class is not so small that the purpose is not of benefit to the community.[81]

Despite its provision for restrictive classes, this section specifically restates the cardinal principle of charitable trusts: there must be an enduring benefit to the community. The number of beneficiaries is a rule of thumb for measuring community benefit, but it is not an end in itself. If the consequences to the community balance out as more adverse than beneficial, the end value is vitiated, and the trust should fail, regardless of the nature or number of beneficiaries. Evidence on the harm to the community of segregated schooling is today too abundant and too compelling for a court ingenuously to ignore. Students whose schooling is segregated receive the benefit of an education, but the value of their education to the community must be discounted by the "social

79. *Id.* at 438 (emphasis added).

80. *See generally* 4 A. Scott, *supra* note 42, § 374. *Cf.* Dorsen, *Racial Discrimination in Private Schools,* 9 Wm. & Mary L. Rev. 39 (1967); Lusk, *The Uncertain Future of Charitable Trusts,* 15 Ala. L. Rev. 390 (1963); Miller, *Racial Discrimination and Private Schools,* 41 Minn. L. Rev. 145 (1957); Parker, *Evans v. Newton and the Racially Restricted Charitable Trust,* 13 How. L.J. 223 (1967); Power, *The Racially Discriminatory Charitable Trust,* 9 St. Louis U.L.J. 478 (1965); Note, *Constitutionality of Racially Restricted Scholarship,* 33 N.Y.U.L. Rev. 604 (1958).

81. *Restatement (Second) of Trusts* § 370(j) (1959).

disvalue" of learning and maturing in a racially segregated environment. Against this discounted value must be balanced the injury done to the community by a practice which invidiously stigmatizes a class of its population.

This is all a very stiff way of stating a doctrine that a growing number of cases have come to represent.[82] In *Howard Savings Institute v. Peep*[83] and in *Estate of Ruth Snively Walker*,[84] Amherst and Stanford (respectively) refused to accept the benefits of testamentary trusts conditioned on racially exclusive uses. In both cases, the respective courts invoked cy pres and voided the racial clauses rather than allowing the trusts to revert to residuary legatees. In *Coffey v. William Marsh Rice University*,[85] a Texas appellate court held that Rice could no longer pursue the purpose of its founder to provide "excellent education" if it was also obligated to follow his provision that it admit only white students. The court, accordingly, eliminated the racial provision from the endowment trust.

The facility with which these courts disposed of racial provisions is ominous for the future of racially exclusionary clauses in charitable trusts. These cases present solid precedent for departing from a strict standard of cy pres whenever it is desirable to mitigate a racially restrictive condition. Although never declared illegal, the restrictive requirements were treated with a disfavor that was equally as lethal. None of the courts found it difficult to subordinate the settlor's intention with respect to the racial restriction, and each appeared to sympathize discreetly with the institution unwilling or unable to enforce an exclusionary clause. In view of these decisions, a conclusion that the law tolerates racial restrictions upon educational charities is questionable.

While these holdings render racial exclusions in charitable trusts unreliable and subject to excision by a court of equity, two cases recently decided go radically further. After *Sweet Briar Institute v. Button*[86] and *Commonwealth of Pennsylvania v. Brown*,[87] racial exclusions in charitable trusts (educational or otherwise) appear to be virtually unenforceable. Sweet Briar Institute, a Virginia college for women, was

82. These cases are cited and discussed in Nelkin, *Cy Pres and the Fourteenth Amendment: A Discriminating Look at Very Private Schools and Not So Charitable Trusts*, 56 GEO. L.J. 272 (1967).

83. 34 N.J. 494, 170 A.2d 39 (1963).

84. No. 70195 (Cal. Super. Ct. 1965).

85. 408 S.W.2d 269 (Tex. Ct. Civ. App. 1966).

86. 12 RACE REL. L. REP. 1188 (W.D. Va. 1967).

87. 392 F.2d 120 (3rd Cir. 1968).

established by a testamentary trust providing for admission of white women only. A Virginia statute in effect when the trust was established permitted charitable trusts for only exclusively white or exclusively colored education. The statute was still in force when Sweet Briar brought an action in a federal district court against the Attorney General of Virginia, seeking a permanent injunction against any suit his office might bring should the college not comply with the racially restrictive terms of its endownment trust. Relying on *Pennsylvania v. Board of Trusts*,[88] a three judge court ordered that ". . . the defendants and their successors in office be, and each of them is hereby, permanently enjoined and restrained from enforcing against the plaintiff any provision in the will . . . limiting education in Sweet Briar Institute of only such girls and young women as are of the white race." [89]

The court might have held the restrictions on the Sweet Briar trust unenforceable because they were required by a statute that contravened the Fourteenth Amendment, or it might have enjoined the attorney general from enforcing that or any law of Virginia against Sweet Briar trustees should they decide to admit Negro students. The court, however, entirely ignored the implications of Virginia law and held that the attorney general would violate the Fourteenth Amendment if he sought to enforce the racial provisions of the endowment trust. The reference to the Girard College case, *Pennsylvania v. Board of Trusts*,[90] suggests the court's rationale. In that, the first phase of the Girard litigation, the Supreme Court found the City Board of Trusts of Girard College to be an agency of the state, subject to the requirements of the Fourteenth Amendment. Presumably, the federal court in *Sweet Briar* reasoned that any action by the attorney general to compel Sweet Briar trustees to comply with racial terms of the trust would effectively convert the trustees to agents of the attorney general. The attorney general would then become the party responsible for the continuing segregation. He would be to Sweet Briar as Philadelphia and Pennsylvania had been to the City Board of Trusts of Girard.

Frequently action by the state attorney general is the only means of enforcing racial restrictions should the trustees of a charitable trust decide to abandon the restrictive terms. It is this important means of enforceability that *Sweet Briar* forecloses. If *Sweet Briar* is followed,

88. 353 U.S. 230 (1957).
89. 12 RACE REL. L. REP. at 1189.
90. 353 U.S. 230 (1957).

an attorney general can no longer act to enforce the racial restrictions of a charitable trust without violating the Fourteenth Amendment.

Brown v. Pennsylvania Board of Trusts,[91] apparently the final sequel to the Girard litigation, not only lends support to *Sweet Briar*, but appears to go further, threatening even privately prosecuted actions to enforce racial exclusions in charitable trusts. The district court in *Commonwealth of Pennsylvania v. Brown*[92] followed *Evans v. Newton*[93] and held that the trustees substituted by the Orphan's Court to oversee Girard College were so "entwined" with the state and so supported by state "momentum" that they were as much an agency of the state as the City Board that preceded them. The district court declined to hold further that the participation of the Orphan's Court in the enforcement of the racial terms of the Girard trusts came within the ambit of *Shelley v. Kraemer*.[94] On appeal, the Third Circuit upheld the trial court's comparison of the Girard College situation with *Evans v. Newton*. But the majority expressly held in addition, that replacing Girard's board of trustees with persons committed to upholding the will violated the limits placed on the judiciary by *Shelley v. Kraemer*. Just as an attorney general's suit would convert private segregation into state segregation, the action of the Orphan's Court made the trustees even more responsive to state authority. Judge McLaughlin, writing for the majority, cited *Sweet Briar* and continued, as though in comparison to the Sweet Briar situation, that:

> Had the City Trustees been left undisturbed it is inconceivable that this bitter dispute before us would not have been long ago lawfully and justly terminated. It is inconceivable that those City Trustees would not have with goodwill opened the College to all qualified children.[95]

Judge McLaughlin implied that had the Girard trustees "raised their sights with the times" and on their own abandoned the racially restrictive provision, judicial action to force compliance with the trust would have involved the state in racial discrimination violative of the Fourteenth Amendment as proscribed by *Shelley v. Kraemer*. By expressly relying on *Shelley*, the Third Circuit extended their holding of *Brown*

91. 392 F.2d 120 (3rd Cir.), *cert. denied*, 391 U.S. 921 (1968).
92. 260 F. Supp. 323 (E.D. Pa. 1966).
93. 382 U.S. 296 (1966).
94. 334 U.S. 1 (1948).
95. 392 F.2d at 125.

v. Pennsylvania Board of Trusts beyond *Sweet Briar. Shelley* involved private covenantees suing to enjoin a covenantor from conveying property to a Negro purchaser. The alignment of this case with *Shelley* appears to mean that in a suit by private parties with standing, a court could not constitutionally enjoin trustees of a charitable trust to adhere to racially exclusionary terms.

Judge Kalodner concurred that "[t]he Fourteenth Amendment is contravened under the *Shelley* doctrine, where there is active intervention of the state courts in the furtherance of enforcement of restrictions denying citizens their civil rights because of their race, color, or creed." [96] Kalodner, however, saw significance in the fact that the Orphan's Court had acted sua sponté. *Brown v. Pennsylvania,* therefore, appears to hold that judicial action to enforce racially restrictive terms in a charitable trust is as violative of the Fourteenth Amendment as judicial action to enforce a racially restrictive covenant in a deed.

It may fairly be concluded, therefore, that the position assumed by the Internal Revenue Service on the law of charities was erroneous, or at least outmoded. It is one of those anachronisms that have become common in the evolution of civil rights law One might challenge this conclusion by arguing that *Sweet Briar* and *Brown v. Pennsylvania* have been interpreted too broadly; that the cy pres cases discussed are too few to be the sample of a trend. In taking up this counter-argument, however, it is at least established that the law of educational charities is in a state of uncertainty If this law is unsettled, it fails as a source of reference for the charitable sections of the Internal Revenue Code.

Two conclusions, then, are tenable. The bolder conclusion is that the law of educational charities does not support the position assumed by the Service in 1967 in granting tax exemption to private segregated schools, and that it is more in accord with the recently announced policy of revoking and denying exemptions. The only other tenable conclusion is that the law of educational charities is in a state of change concerning the question of racial restrictions, and therefore an analogy to charitable trusts on this question is indecisive. It neither supports nor opposes tax exemption for private segregated schools. In any case, it is at least clear that this body of law will not sustain exemptions for

96. *Id.*

racially restricted schools, and the Internal Revenue Service's use of trust law as a basis for exemption was a misapplication of the law.

THE TANK TRUCK DOCTRINE

The basis for grounding the allowance of tax exemptions to private, segregated schools in the common law of trusts, if it ever existed, has certainly dissipated. At the same time, an opposing theory first put forth by the Civil Rights Commission has been recognized. Its basis is the common sense rule that the Internal Revenue Code should be applied in consonance with other laws and policies, and particularly the Constitution. The decision in *Green v. Kennedy*,[97] it will be recalled, turned on this fundamental point. In tax law this principle has most often been recognized in what has commonly been called the *Tank Truck* doctrine.

The lower federal courts developed a rule of tax policy disallowing business deductions for fines or forfeitures paid by a business for having violated a law or regulation. In 1958, the Commissioner of Internal Revenue brought three cases to the Supreme Court that turned on the disallowance rule conceived in the lower courts. In *Tank Truck Rentals, Inc. v. Commissioner*,[98] the Court gave its imprimature to the rule and elaborated the doctrine behind it.[99]

The decision in *Tank Truck* denied the taxpayer a business deduction under Internal Revenue Code section 162(a) for penalty fines it had paid. The taxpayer, a truckline, had incurred the penalties for violation of highway maximum weight laws. The Court felt that it was improper, as a matter of policy, to sanction deductions that would frustrate national or state policies, by mitigating the "sting" of the state-imposed penalty. Speaking more generally, Justice Clark for the Court stated:

> We will not presume that the Congress, in allowing deductions

97. 309 F. Supp. 1127 (D. D.C. 1970). *See* text accompanying notes 29-32 *supra*.

98. 356 U.S. 30 (1958).

99. Great Northern Ry. Co., 8 B.T.A. 225, *aff'd*, 40 F.2d 372 (8th Cir. 1927) is said to be the origin of the *Tank Truck* doctrine. For a discussion prior to *Tank Truck*, *see* Lurie, *Deductibility of "Illegal" Expenses*, [1952] N.Y.U. 11TH INST. ON FED. TAX. 1189. *See also* ALI FED. INCOME TAX STAT. § X154(i) (May 1952 draft); 4 J. MERTENS, LAW OF FEDERAL INCOME TAXATION, §§ 25.50-.54, 25.131-.136 (1960); Tyler, *Disallowance of Deductions on Policy Grounds*, 20 TAX L. REV. 665 (1965); Note, *Business Expenses, Disallowance, and Public Policy: Some Problems of Sanctioning with the Internal Revenue Code*, 72 YALE L.J. 108 (1962).

> for income tax purposes, intended to encourage a business enterprise to violate the declared policy of a State . . . . Although each case must turn on its own facts . . . the test of nondeductibility always is the severity and immediacy of the frustration resulting from allowance of the deduction. The flexibility of such a standard is necessary if we are to accommodate both the congressional intent to tax only net income, and the presumption against congressional intent to encourage violation of declared public policy.[100]

In *Commissioner v. Sullivan*,[101] a companion case, the Court held payments for rent and wages by an Illinois "bookmaker" to be deductible business expenses, despite the fact that the payments were in violation of Illinois law. In explanation, it was pointed out that a deduction in this case would not allow the taxpayer to evade or diminish the penalties for "bookmaking" under state law. Justice Douglas emphasized that, *Tank Truck* notwithstanding, the federal income tax was imposed on a net income base. "If we enforce the rule espoused by the Commissioner in this case, we would come close to making this type of business taxable on the basis of its gross income. If that choice is to be made, Congress should do it." [102] The rule has thus been left to case-by-case construction and has been applied almost exclusively under section 162(a) (business expenses), although it has occasionally been extended to section 165 (business losses). The meaning of "frustration" is still open to refinement, and likewise the requirement that the policy frustrated be "declared government policy" is still malleable. "Government policy" has not been refined to mean only state or federal statutes, but has normally been used interchangeably with "public policy," with several implicit conditions to be discussed below.[103] The preceding outline of the *Tank Truck* doctrine is sufficient for dealing with the obstacles faced in carrying it over to sections 170(c) and 501(c)(3).

Because the *Tank Truck* policy has been applied only under section 162(a) and section 165 of the Code, extension to sections 170(c) and 501(c)(3) would be an innovation. Despite this novelty, *Tank*

100. 356 U.S. at 35.

101. 356 U.S. 27 (1958).

102. *Id.* at 29. *See* Griswold, *An Argument Against the Doctrine that Deductions Should be Narrowly Construed as a Matter of Legislative Grace*, 56 HARV. L. REV. 1142 (1943).

103. *See also* B. BITTKER, *supra* note 7, at 279-84.

Truck actually applies more consistently to the charitable sections than to the business expense and loss sections because disallowance of a charitable deduction does not violate the fundamental of taxing only net income. Deductions under the Code may be grouped into three classes:[104]

(i) expenses incurred in the production of income;
(ii) involuntary personal expenses (e.g., personal exemptions, state taxes, medical expenses, interest, dependency deductions);
(iii) charitable deductions.

Denial of a charitable deduction does not in any manner convert the tax base to a gross income base, for with or without the section 170(c) deduction, taxable income is still net after business expenses, and it is still the net after deduction of "involuntary personal expenses." Similarly, denial of charitable exemption under section 501(c)(3) results only in taxing an institution on its net income. The *Tank Truck* doctrine, therefore, carries over to the charitable sections of the Code without encountering the objections to a gross income tax expressed in *Sullivan*.[105] It applies without friction under these sections, in contrast to its application under the business expense and loss sections where it is in conflict with the nature of the federal income tax.

Although the application of the *Tank Truck* policy under the charitable sections of the Code would not impair the basic scheme of a net income tax, it might be argued that it would clash with the purposes of the charitable sections. The purpose of permitting charitable deductions is generally accepted as the encouragement of private wealth diffusion to beneficial public uses. The charitable exemption is commonly rationalized as relieving from taxation organizations which serve the public good, and whose service would be cut back pro tanto by taxation. There is the added argument that the government strikes a good bargain by giving exemptions and deductions; the cost of foregone revenues is said to be less than what the government would have to spend to provide the public services.[106]

104. White, *Deductions for Nonbusiness Expenses and an Economic Concept of New Income*, JOINT COMM. ON ECONOMIC REPORT, FEDERAL TAX POLICY FOR ECONOMIC GROWTH AND STABILITY, 84th Cong., 1st Sess. 353 (1955).

105. Commissioner v. Sullivan, 356 U.S. 27 (1958). *See* text accompanying notes 101, 102 *supra*.

106. For a critical examination of these theories *see* Rabin, *Charitable Trusts and*

Libertarians have perceived something more in these sections. In their view, the charitable sections of the Code symbolize a preference for private centers of action and innovation. The important fact is not so much that private wealth diffuses to the public good, but that the decision as to what constitutes the public good devolves upon the private sector. They find social, political, and economic value in this devolution.[107]

Socially and politically it is argued that decentralization favors pluralism and polycentralism. Political theorists have observed that a multiplicity of independent, private institutions is conducive to democracy.[108] Economically, it may be argued that private organizations serving the public good are more responsive, more efficient in the services they render, and more innovative.[109] This point of view implies a minimum of administrative manipulation. If charitable deductions and exemptions were too closely regulated, the preferences of the IRS would supplant private preferences, and the libertarian mechanism would collapse.

While this argument has force, it also has limits. It is one thing to say that the charitable sections of the Code express a preference for private centers of action and innovation. It is quite another to say that the government through these sections invites the private sector to frustrate its official policies. Part of the libertarian argument is an emphasis upon efficiency, and it would scarcely be efficient for the government to commit itself to a particular policy and simultaneously induce private institutions to take up a contrary course of action.

More relevant here is the argument that ours is a plural society, and that the charitable sections of the Code stem from the tolerance that makes pluralism functional. This argument, too, has its limits. Not all values can be defended in the name of pluralism, and it scarcely follows from pluralism that government is morally neutral on all matters.

Charitable Deductions, 41 N.Y.U. L. REV. 912 (1966); Wolfman, *Federal Tax Policy and the Support of Science*, 114 U. PA. L. REV. 171 (1965). The Rabin article discusses Taussig, *The Charitable Contributions Deduction in the Federal Personal Income Tax* (1965) (unpublished doctoral dissertation on file at Massachusetts Institute of Technology and New York University libraries).

107. A collection of sources representing this point of view is contained in Rabin, *supra* note 106, at 920-25. *See* Broughton, *The Economic Function of Foundations*, FOUNDATION NEWS, Sept. 1964, at 1; Case, *Philanthropy as a Social Investment*, FOUNDATION NEWS, March 1964, at 1.

108. S. LIPSET, J. COLEMAN, M. TROW, UNION DEMOCRACY 13-16 (1956).

109. *See* Saks, *The Role of Philanthropy: An Institutional View*, 46 VA. L. REV. 516, 524 (1960).

Some consensus values are enforced, notwithstanding views to the contrary. Incorporation of *Tank Truck* would only make these values operative in the charitable sections of the Code. The doctrine might give the IRS more leverage in ruling on exemptions and deductions, but it would not open the door to displacement of private preferences by bureaucratic values, because it could only be invoked to avoid the frustration of "declared government policy."

The charitable sections of the Code cannot reasonably be permitted to commit the non sequitur of encouraging private action to thwart government policy. What Justice Clark said of section 162(a) in *Tank Truck* may as plausibly be said of section 170(c) and section 501(c)(3).[110] It should be equally improper as a matter of policy to sanction charitable deductions for exemptions that would "frustrate sharply defined national or state policies proscribing particular types of conduct, evidenced by some government declaration thereof." [111]

The question that remains is whether there is a public policy, meeting *Tank Truck* standards, that is frustrated by exempting segregated private schools from taxation. For *Tank Truck* purposes, "public policy" is a notional concept that falls somewhere between private ethics and statutory law. The Supreme Court in *Lilly v. Commissioner*,[112] established that the public policy to be accommodated in the tax code must have more sanction than merely business or professional ethics. It must at least be evidenced by some governmental declaration, but from which level of government the declaration must emanate is not entirely certain. Following *Lilly*, in *Kirtz v. United States*,[113] the Court of Claims upheld a deduction taken by an insurance agent on kickbacks to corporate officers who had procured their corporation's insurance business for him. The court implied that had the practice been condemned by the state insurance commissioner the kickbacks would have been nondeductible. The court added, however, that had the kickbacks been malum in se, they would have been nondeductible—with or without an edict from the commissioner.

While the reference to a standard of malum in se is nebulous, apparently on this criterion, a number of courts have disallowed deduction for commercial bribes, resting their decision not so much on specific statutes, but on a more implicit policy opposed to bribery. Why it is

110. *See* text accompanying note 100 *supra*.
111. 356 U.S. at 31.
112. 343 U.S. 90 (1952).
113. 304 F.2d 460 (Ct. Cl. 1962).

that bribes are more venal than kickbacks is not clear, but presumably if the practice is universally execrated, the government may be assumed to oppose it.

The Supreme Court has shed some light on the source of "public policy" in its latest decision on the *Tank Truck* doctrine, *Commissioner v. Tellier*,[114] in which it held that public policy did not bar the deduction of legal expenses for defense against criminal prosecution. The decision upset a body of lower court precedent to the contrary, but the Court regarded the reasoning of previous cases as seriously mistaken:

> No public policy is offended when a man faced with serious criminal charges employs a lawyer to help in his defense. That is not 'proscribed conduct.' It is his constitutional right . . . . In an adversary system of criminal justice, it is a basic of our public policy that a defendant in a criminal case have counsel to represent him.[115]

For this conclusion, the Court cited *Gideon v. Wainwright*,[116] the Criminal Justice Act of 1964,[117] and, more broadly, the adversary system and the Constitution. By thus citing *Gideon*, the Supreme Court implied that judicial opinions may evidence "government declarations" of policy.

On the same model of reasoning, *Brown v. Board of Education*[118] (and cases following it), and Title VI of the Civil Rights Act of 1964[119] reflect a "declared government policy" broadly opposed to segregated education. *Brown* addresses itself specifically to public schools but the opinion, as noted above, condemns all racially segregated education. Title VI applies only to schools receiving federal assistance funds, but viewed contextually, is indicative of the federal government's opposition to segregated schooling. Further, the policy of an assortment of Fourteenth Amendment decisions is violated, repulsed, or frustrated by granting tax exemption to segregated private schools. For example,

114. 383 U.S. 687 (1966).

115. *Id.* at 694.

116. 373 U.S. 335 (1963). In *Gideon*, the Supreme Court held that indigent criminal defendants in state courts are entitled to have counsel appointed by the court to assist in their defense.

117. 18 U.S.C. § 3006(a) (1965). According to its provisions, an indigent defendant charged with a federal crime is entitled to have reasonable counsel fees and litigation expenses paid by the United States.

118. 347 U.S. 483 (1954).

119. 42 U.S.C. §§ 2000d-2000d-4 (1964).

in *Burton v. Wilmington Parking Authority*,[120] the Court intimated that the state in leasing its property might have exacted a covenant not to discriminate from the Eagle Coffee Shoppe. Partly because of this abdication in the face of an opportunity to restrain racial discrimination, the state was held to have "insinuated" itself into the coffee shop's refusal to serve Negroes. By comparison, the IRS probably could not prohibit private school segregation by disallowing the schools tax exempt status, but by granting exemption, the Service would lose an opportunity to make racial discrimination by these schools more difficult.

Burton, of course, applies the Fourteenth Amendment. But on the authority of *Bolling v. Sharpe*,[121] the same standards would probably apply to the federal government through the Due Process Clause of the Fifth Amendment. In fact pursuant to Executive Order 11246,[122] the federal government requires that government contractors not discriminate racially in their employment policies. An earlier Executive Order requires a similar vigilance against discrimination on the part of all government agencies in their transactions related to residential housing.[123] It was thus anomalous that the IRS dispensed tax benefits to private segregated schools while the FHA could not insure mortgages on property burdened by a racial covenant, and the Defense Department could not make a contract without a commitment on the part of its contractor to avoid discriminatory employment practices. Tax exemption of private segregated schools is, in effect, a condonation of racial discrimination inconsistent with decisional law and with policies that have been promulgated by the executive branch. Moreover, a grant of tax exemption gives the government's recognition to the school and its approval to a policy that racially restricted education is nonetheless charitable in nature, of benefit to the community, and an act of public good deserving favored tax treatment. This recognition is in itself, quite apart from any tax benefits bestowed, at odds with the policy of the Fourteenth Amendment.

The Supreme Court has reached this conclusion in a number of cases. In *Lombard v. Louisiana*,[124] and *Peterson v. City of Greenville*,[125]

120. 365 U.S. 715 (1961).
121. 347 U.S. 497 (1954).
122. 3 C.F.R. 339 (Supp. 1967).
123. Exec. Order No. 11,063, 3 C.F.R. 652 (Supp. 1964).
124. 373 U.S. 267 (1963).
125. 373 U.S. 244 (1963).

city and county officials publicized their approbation of segregation in local restaurants. The Court found their approval to have colored private discrimination with state action. Reviewing these and other Fourteenth Amendment cases, a three-judge federal court in *Lee v. Macon County Board of Education*[126] decided that it is "axiomatic that a state may not induce, encourage, or promote private persons to accomplish what it is constitutionally forbidden to accomplish." [127] The Supreme Court, too, gave its sanction to this proposition in *Reitman v. Mulkey*.[128] In striking down a California constitutional amendment that would have effectively foreclosed open-housing legislation, the Court held that the provision would involve the state in racial discrimination in violation of the Fourteenth Amendment.

The exemption of private segregated schools from federal taxation is not condemned as such by *Brown*, *Burton*, *Lombard*, or *Reitman*, but each of these cases in its own way espouses a policy opposed to state approval, encouragement, or even condonation of racial discrimination. By overlooking discrimination prior to July 1970, the Service has in a sense, condoned private school segregation. By certifying that such schools served the public good and deserved favored tax treatment, the Service granted these schools a form of official approval. Every solicitation for funds could bear the notation that the school had been approved by the IRS as charitable, and therefore, that gifts would be tax-deductible. Moreover, to the extent that tax deduction made donations more attractive, and to the extent that tax exemption eased operating costs, the Service can be charged with having helped to finance and encourage the development of private segregated schools.

Soon after *Brown v. Board of Education*, the Supreme Court broadly stated its opinion of government financial assistance to segregated schools. Taking critical notice of developments towards desegregation in Arkansas in *Cooper v. Aaron*,[129] the Court admonished that "State support of segregated schools through any arrangement, management, funds, or property cannot be squared with the Fourteenth Amendment's command that no State shall deny to any person within its jurisdiction the equal protection of the laws." [130]

126. 267 F. Supp. 458 (M.D. Ala. 1967). A tuition grant statute was determined to be an integral part of a state sponsored move to maintain a dual school system.

127. *Id.*

128. 387 U.S. 369 (1967).

129. 358 U.S. 1 (1958).

130. *Id.* at 19.

In its 1967 news release, the Service announced that *Cooper v. Aaron* was its basis for refusing exemption to any private segregated schools that were direct recipients of state financial support.[131] Perhaps the Service felt that literal adherence to the *Cooper* dictum was proper and deferential to the Supreme Court, but it hardly did justice to the Court to attribute to it a distinction of such naivete. In *Griffin v. State Board of Education*,[132] this distinction was summarily dismissed: "Nor do we think weight is to be accorded to the fact that the money is paid to the pupil or the parent, and not to the school, for the pupil or the parent is a mere channel." [133] The *Griffin* court felt that it was enough to hold that predominant state support of segregated private schools is unconstitutional. Later decisions further reduced the criteria. In *Poindexter v. Louisiana Financial Assistance Commission*,[134] the court pointed out that "[a] segregated school predominantly supported by State funds is an *a fortiori* case of unconstitutional State action." [135] *Simkins v. Moses H. Cone Memorial Hospital*[136] indicates how low the level of government assistance can go and still amount to state action. Cone Memorial Hospital received 17 percent of the cost of two additions in Hill-Burton funds. Because of this financial assistance from the federal government, the Fourth Circuit Court of Appeals ordered the hospital to cease its discriminatory practices. Shortly thereafter, this standard was codified in Title VI of the Civil Rights Act of 1964:

> No person in the United States shall, on the ground of race, color, or national origin, be excluded from participation in, be denied the benefits of, or be subjected to discrimination under any program or activity receiving Federal financial assistance.[137]

Cone authorized injunctive relief, whereas Title VI prescribes a selective termination of federal funding. Both, however, are alike in disapproving discrimination in *any* program or institution that is receiving *any* amount of federal financial assistance. Though *Cooper* and *Cone*, like *Burton* and *Reitman*, are not specifically addressed to tax exemption, they unarguably evidence a policy opposed to government financial

131. Internal Revenue Service News Release, *supra* note 21.
132. 239 F. Supp. 560 (E.D. Va. 1965).
133. *Id.* at 563.
134. 275 F. Supp. 833 (E.D. La. 1967).
135. *Id.* at 853.
136. 323 F.2d 959 (4th Cir. 1963), *cert. denied*, 376 U.S. 938 (1964).
137. 42 U.S.C. § 2000d (1964).

involvement with segregated institutions. If tax exemption for private segregated schools would not give grounds for action against the Service under the Fourteenth Amendment, it would nevertheless be irreconcilable with policies that have grown out of the amendment.[138] Whether or not exemption would directly violate the amendment, it clearly would not represent the accommodation between the tax code and "declared government policy" which the *Tank Truck* doctrine requires.

CONCLUSION

It seems fair to conclude that federal tax exemption of private, segregated schools cannot be defended upon any reasonable grounds. The initial decision to exempt such schools was insupportable on its face. It required the Internal Revenue Service to overlook its own sundry rulings over a period of years, as well as the policies and practices of numerous federal agencies. The Service claimed to find a basis for its position in charitable trust law, but only by ignoring a growing trend of decisions can exemption be rationalized by analogy to the law of charitable trusts. It is clear, moreover, that exemption of private, segregated schools tended to frustrate an established objective of the Fourteenth Amendment and a policy pursued by the federal government for more than a decade. Such a contradiction of policy is opposed by both precedent and logic, and perhaps the strongest grounds for denying exemption is to be found in the *Tank Truck* doctrine. The announcement by the Commissioner of Internal Revenue in July 1970 is a welcome and overdue recognition that the exemption of private, segregated schools has no foundation in federal tax law.

138. *See* Note, *Federal Tax Benefits to Segregated Private Schools*, 68 COLUM. L. REV. 922 (1968).