

OBERGEFELL, BOB JONES, AND THE IRS

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Could a charitable hospital jeopardize its tax-exempt status by opposing same-sex marriages? For example, what if a hospital's visitation rights policy denied a same-sex spouse access to his or her spouse's hospital room? Hypothetical tax questions, one might have said, but exactly how hypothetical? On June 26, 2015, the U.S. Supreme Court issued its decision in *Obergefell v. Hodges*,² which held that the Due Process and Equal Protection Clauses of the Fourteenth Amendment to the U.S. Constitution guaranteed same-sex couples the right to marry. During the oral arguments in *Obergefell*, Justice Samuel Alito and Solicitor General Donald Verrilli engaged in an exchange about the possible implications of the Court's 1983 decision in *Bob Jones University v. United States*³ if the Court should rule in Mr. Obergefell's favor in the pending case. As reported in the media,⁴ the exchange consisted of:

Justice Alito: So would the same apply to a university or a college if it opposed same-sex marriage? That is, would the IRS be acting within its authority if it decided it could revoke the tax-exempt status of a school opposed to same-sex marriage?

Solicitor General Verrilli: You know, I—I don't think I can answer that question without knowing more specifics, but it's certainly going to be an issue. I—I don't deny that. I don't deny that, Justice Alito. It is—it is going to be an issue.

The exchange gave rise to speculation in the media and an unusual letter to Senate Majority Leader Mitch McConnell (R-KY) and then House Speaker John Boehner (R-OH) signed by 15 state attorneys general, contending that the Internal Revenue Service (IRS) was likely to use the *Obergefell* decision to assert that religiously based tax-exempt organizations, such as schools, jeopardize their tax status if they engage in discriminatory behavior, presumably in access to services or employment, towards individuals in same-sex marriages. While not mentioned in the attorneys general letter, by implication, religiously oriented hospitals might be swept up in such a rule, as well. Justice Alito's choice of words, "if it [the IRS] decided it could revoke the tax-exempt status of a school that was opposed to same-sex marriage," suggests that the decision to undertake such an action might well be made spontaneously by the IRS. Solicitor General Verrilli's reply did nothing to put either *Bob Jones* or the IRS action that led to the Supreme Court decision in the proper legal and historical context. The letter from the 15 state attorneys general likewise ignored the legal context for the *Bob Jones* decision and asserted the IRS could "target disfavored beliefs in any religious organization, to effectively decide the truth or correctness of a religious belief, and to penalize as a matter of 'policy' a mainstream belief held by groups that long have received tax-exempt status."⁵

It is also worth noting that the Internal Revenue Manual explicitly provides that the IRS, in the context of religious organizations and tax exemption, cannot pass judgment on the merits of the asserted religious belief.

In reality, the IRS does not evaluate the appropriateness of particular religious beliefs, as exemplified by the agency's May 21, 2015 determination (released a little over a month before the state attorneys general letter) that the First Church of Cannabis qualified for tax-exempt status.⁶ It is hard to envision a better example of IRS' reluctance to inquire into the bona fides of religious belief, mainstream or not. It is also worth noting that the Internal Revenue Manual explicitly provides that the IRS, in the context of religious organizations and tax exemption, cannot pass judgment on the merits of the asserted religious belief.⁷

While I do not have access to a proverbial crystal ball that would enable me to predict the likelihood that Congress might modify the Internal Revenue Code to require non-discrimination on the basis of sexual orientation as a condition of federal income tax exemption, I do have a perspective on the likelihood that the Treasury Department and the IRS will issue a revenue ruling enunciating the same principle. At the time the Supreme Court handed down its decision in *Bob Jones*, I was the Technical Advisor to the Director of the IRS Exempt Organizations Division and directly involved in the enforcement of federal tax laws applicable to tax-exempt organizations, including private schools. At the time, the Exempt Organizations Division administered the provisions of the Internal Revenue Code applicable to tax-exempt organizations, reporting to the Assistant Commissioner for Employee Plans and Exempt Organizations. The Division's responsibilities included the development of technical and procedural guidance for revenue agents conducting examinations of tax-exempt organizations, in conjunction with the IRS Office of Chief Counsel and the Office of Tax Policy at the Treasury Department, as well as the

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final administrative evaluation of cases deemed of precedential import as they moved through the internal IRS appeals process.

The action that brought Bob Jones University to the Supreme Court was the revocation of the University's tax-exempt status based on a determination that the institution's racially discriminatory policies violated public policy. The IRS action was based on a legal position set forth in Revenue Ruling 71-447.⁸ Revenue rulings are an official statement of the application of federal tax law to a particular set of facts and thus signal how the IRS will approach particular issues when confronted with them in the process of tax administration. Taxpayers are entitled to rely on the analysis and conclusions set out in revenue rulings to the extent that their facts are aligned with the facts set forth in the revenue ruling.⁹ Revenue Ruling 71-447 analyzed the federal tax implications of a private school that did not have a racially non-

discriminatory policy as to students and concluded, based on an analysis of federal statutes and court decisions, that such an institution did not qualify for federal income tax exemption.

Revenue Ruling 71-447, together with another ruling that applied Revenue Ruling 71-447 in the context of a church-operated private school teaching secular subjects, were part of the guidance provided to revenue agents. These rulings only applied to private schools teaching secular subjects.¹⁰ The revenue rulings did not apply to other types of tax-exempt organizations, such as churches engaged in religious worship services. And these rulings did not arise in a vacuum: in 1969, a class action, *Green v. Kennedy*,¹¹ was brought by black parents and their children attending public schools in Mississippi seeking to enjoin the Secretary of the Treasury and the IRS Commissioner from according tax-exempt status to private schools in Mississippi that discriminated on the basis of race. In June 1970, the district court ordered the IRS to suspend advance assurance of deductibility of contributions to segregated Mississippi private schools. White parents of children attending Mississippi private schools had been allowed to intervene in *Green*, and they sought Supreme Court review of the order. The appeal was dismissed by the Supreme Court in January 1971.¹² In July 1971, in *Green v. Connally*,¹³ the U.S. District Court for the District of Columbia issued a permanent injunction against the IRS with regard to the tax-exempt status of private schools in Mississippi, and later in 1971, Revenue Ruling 71-447 was issued setting forth the position of the IRS in response to the injunction. In its decision containing the permanent injunction, the district court specifically addressed public policy and federal tax benefits:

Before considering the more particular subject of charities, we refer to the general and well-established principle that the Congressional intent in providing tax deductions and exemptions is not construed to be applicable to activities that are either illegal or contrary to public policy. For example, the dependency deduction was construed in *Leon Turnipseed*, 27 TC 758 (1957), to disallow such deduction if the relationship between the taxpayer and the "dependent" was in violation of local law.

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The path leading to Revenue Ruling 71-447 and the *Bob Jones University* decision is a long one, even if one only looks at developments in the wake of the "separate but equal" decision in

Plessy v. Ferguson.¹⁴ With the founding of the NAACP in 1909 with the goal of securing the rights guaranteed in the Thirteenth, Fourteenth, and Fifteenth Amendments to the U.S. Constitution, the organization began to methodically challenge racial discrimination, moving through voting rights to education. The *Brown v. Board of Education* decisions¹⁵ focused attention on efforts by state and local governments to avoid or minimize public school integration. In *Cooper v. Aaron*,¹⁶ the Supreme Court addressed efforts by the state of Arkansas, to derail integration of public schools in Little Rock through a variety of means, including the device of the Little Rock Private School Corporation.¹⁷

In 1964, Congress reinforced the Supreme Court's ruling on integration in the Civil Rights Act of 1964, and decisions on racial discrimination in education began to flow from the Supreme Court at an increasing rate; two in particular are important for understanding the Supreme Court's decision in *Bob Jones*. In 1973, the Supreme Court issued its opinion in *Norwood v. Harrison*,¹⁸ holding that a state may not provide support to a private school that discriminates on the basis of race. In 1976, in *Runyon v. McCrary*,¹⁹ the Supreme Court held that federal law, 42 U.S.C. § 1981, prohibited private schools from discriminating on the basis of race. By the time that the Supreme Court heard arguments in the *Bob Jones* case, more than 50 years of federal court decisions had addressed racial discrimination in a variety of contexts, and, as noted by the Supreme Court, in an "unbroken line of cases following *Brown v. Board of Education*" established beyond doubt that "racial discrimination in education violates a most fundamental national public policy, as well as the rights of individuals."²⁰ It was only after the years of litigation, including an injunction against the IRS with specific regard to the continued favorable tax treatment of racially discriminatory private schools, did the Treasury and the IRS issue Revenue Ruling 71-447. Clearly, the analysis enunciated in the revenue ruling had long roots in decisions of courts at all levels, as well as statutes enacted by Congress.

The path that led to the *Bob Jones* decision reflected the history of race relations in the United States; issues of same-sex marriage and equality may well travel a similar path, but the nature and direction of that path is yet to be determined. It is possible that state legislatures, Congress, and the federal courts, including the Supreme Court may well end up applying the precedents derived from the struggle against racial discrimination in the context of same-sex relationships, but from its record on racial discrimination, it seems apparent that the IRS will be following, not leading, the development of public policy.

It is worth noting that the Supreme Court decision in *Grove City College v. Bell*,²¹ addressing gender discrimination in federally funded college programs, did not result in IRS actions to

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revoke the tax-exempt status of educational organizations that discriminated on the basis of gender, nor has the IRS attempted to address racial discrimination and tax-exemption in matters not specifically addressed by statute or court decisions. As a result, it is improbable that the events suggested by Justice Alito in his exchange with Solicitor General Verilli will come to pass without the intervention of Congress or the courts. That would have been made clear to all if Solicitor General Verilli's response had been "Mr. Justice, if this Court were to find that discrimination against persons in same-sex marriages violates the law, as this Court did with regard to private schools and racial discrimination in *Norwood v. Harrison* and *Runyon v. McCrary*, then I am confident that the IRS would take appropriate steps to ensure that organizations operating in violation of the law are not entitled to tax-exempt status, just as the agency did with regard to *Bob Jones University*." Such a response would have had the benefit of being legally accurate and straightforward in its message that the IRS follows public policy as determined by Congress and the courts, not its own agency views.

In conclusion, *Obergefell* will, by itself, not affect the tax-exempt status of particular organizations, but Congress or the courts are the entities most likely to change that outcome, if so inclined, not the IRS. **■**

About the Author



Marcus Owens (mowens@loeb.com) represents a broad range of nonprofit organizations, including private foundations, charities, lobbying/political organizations, and trade associations. The context has ranged from tax planning, the process of formation and

application for exemption, through IRS and state attorney general investigations, including complex audits by IRS Exempt Organizations Financial Investigative Units. Mr. Owens' focus includes executive compensation, excess benefit and self-dealing excise taxes, as well as the impact of digital and social media on tax-exempt organizations. His experience also extends to social impact investing and program-related investments. Particular projects have involved the emerging rules for foreign grant making and organizations interested in public policy but concerned with legislative and political activities. Mr. Owens is also a frequent lecturer, writer, and commenter on the complex laws affecting exempt organizations. Prior to entering private practice, Mr. Owens was employed by the Exempt Organizations Division of the Internal Revenue Service and served as the division's director for ten years. In that capacity, he was the chief decision maker regarding design and implementation of federal tax rulings and enforcement programs for exempt organizations, political organizations and tax-exempt bonds. He also served as the IRS' primary liaison with other federal agencies, Congress, and state regulators on exempt organizations issues.

Endnotes

- 1 Under the Alabama "Sanctity Laws," hospitals in the state are prohibited from allowing visitation rights to members of same-sex couples. The application of the laws in the context of a hospital that barred a party in a same-sex marriage from visiting his dying spouse is being challenged in *Hard v. Bentley*, Civil Action No. 2:13-cv-00922-WKW-SFW (M.D. Ala.).
- 2 *Obergefell v. Hodges*, 135 S. Ct. 2071 (2015).
- 3 *Bob Jones Univ. v. United States*, 461 U.S. 574 (1983).
- 4 See <http://blog.acton.org/archives/77937-how-the-federal-government-may-put-christian-schools-out-of-business.html#.VqqNchu0-Z8.email>.

- 5 July 2, 2015 letter from Patrick Morrissey, Attorney General of West Virginia, together with 14 other state attorneys general, to Sen. Mitch McConnell and Rep. John Boehner.
- 6 See <http://www.cbsnews.com/news/cannabis-church-gets-tax-exempt-status/>.
- 7 Internal Revenue Manual § 7.25.3.6.4.
- 8 Revenue Ruling 71-447, 1971-2 C.B. 230.
- 9 Treas. Reg. § 601.601(d)(2).
- 10 Revenue Ruling 75-231, 1975-1 C.B. 158.
- 11 *Green v. Kennedy* 309 F. Supp. 1127 (D.D.C. 1970).
- 12 *Coit v. Green*, 400 U.S. 986 (1971).
- 13 *Green v. Connally*, 330 F. Supp. 1150 (D.D.C. 1971).
- 14 *Plessy v. Ferguson*, 163 U.S. 537 (1896).
- 15 *Brown v. Board of Education*, 347 U.S. 483 (1954).
- 16 *Cooper v. Aaron*, 358 U.S. 1 (1958).
- 17 *Aaron v. Cooper*, 261 F.2d 97 (8th Cir. 1958).
- 18 *Norwood v. Harrison*, 413 U.S. 455 (1973).
- 19 *Runyon v. McCrary*, 427 U.S. 160 (1976).
- 20 *Bob Jones Univ. v. United States*, 461 U.S. 574 (1983).
- 21 *Grove City College v. Bell*, 465 U.S. 555 (1984).

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