

OBERGEFELL AND TAX-EXEMPT STATUS FOR RELIGIOUS INSTITUTIONS

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The question presented is whether the Internal Revenue Service’s response to an inquiry from Attorney General Pruitt of Oklahoma regarding whether there would be any impact on tax-exemption standards in light of the Supreme Court decision in *Obergefell v. Hodges*¹ was “right.” Specifically, Attorney General Pruitt’s letter had asked IRS Commissioner Koskinen in a July 30, 2015 letter whether *Obergefell* “would have an effect on the IRS’s administration of the tax laws regarding tax-exempt organizations.”² Presumably Attorney General Pruitt’s inquiry was motivated by his concern over one particular exchange that Justice Alito had with Solicitor General Verrilli during the oral argument in *Obergefell*. Justice Alito had asked the Solicitor General about the impact that a decision in favor of the plaintiff would have on the tax-exempt status of religious institutions that would not recognize same-sex marriage. The Solicitor General stated in reply:

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.

Commissioner Koskinen replied that “[t]he IRS does not view *Obergefell* as having changed the law applicable to section 501(c)(3) determinations or examinations. Therefore, the IRS will not . . . change existing standards in reviewing applications for exemption under section 501(c)(3) or in examining the qualification of section 501(c)(3) organizations.”

The Commissioner’s reply is fairly succinct and direct: an organization’s refusal to perform a same-sex marriage (or perhaps merely recognize a same-sex marriage) will have no effect on its ability to obtain (or retain) recognition of tax-exempt status. But the real question here is not whether the Commissioner’s statement is simply a factually correct statement of position – presumably he means what he says – but whether there is a technical federal tax law justification for his conclusion.

Unfortunately, the Commissioner did not supply an underlying rationale for his conclusion so we must see if one can be supplied. The authors believe that there are strong

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¹ 576 U.S. ____ (2015).

² Throughout this note the term “tax-exempt” will be used to refer to organizations described in Section 501(c)(3) of the Internal Revenue Code of 1986, as amended (the “Code”), notwithstanding that the Code makes provision for numerous other types of tax-exempt status.

arguments that the Internal Revenue Service should change its view on the issue based on applicable law as it stands. Under current Supreme Court precedents private persons lack standing to force the Internal Revenue Service to change its position. Thus at present, only Congressional action could actually force the Internal Revenue Service to take into account an organization's refusal to perform a same-sex marriage (or recognize a same-sex marriage) in assessing tax-exempt status.³ We predict though that in the long run the Internal Revenue Service is likely to move in the direction of regarding *Obergefell* as in fact changing standards in reviewing applications for exemption under section 501(c)(3) or in examining the qualification of section 501(c)(3) organizations and acting accordingly. The Internal Revenue Service could have sent the same letter to an inquirer after the Supreme Court decision in *Brown v. Board of Education*⁴ – in fact, the Internal Revenue Service *de facto* acted as though *Brown* had no effect on standards for tax-exempt status for almost sixteen years. Ultimately the Internal Revenue Service revised its view on the impact of racial discrimination and tax-exempt status, and we believe that is likely to take place here as well.

Obergefell has a fairly simply stated holding: the Constitution does not permit a State “to bar same-sex couples from marriage on the same terms as accorded to couples of the opposite sex.” Many tax-exempt organizations have the power to marry individuals under state law – for example, most churches and similar religious bodies have that power.⁵ Such organizations that henceforth refuse to marry same-sex couples appear to be acting directly in contravention of the holding in *Obergefell*. Likewise, many tax-exempt organizations specially acknowledge married persons in some manner – for example, colleges and universities that provide married student housing. The case of religious colleges and universities essentially raises the same issues as the hypothetical posed by Justice Alito. In this latter case, an organization that refuses to offer married student housing to same-sex couples would not be acting directly in contravention of the holding in *Obergefell*, but is arguably at least indirectly rejecting that holding by rejecting acknowledgment of a Constitutional right. There may be other tax-exempt organizations that seek to deny recognition of the status of same-sex married couples (*e.g.*, refusing to rent facilities for weddings and receptions).

We will confine ourselves for purposes of this note to the simplest case - tax-exempt organizations that have state-sanctioned authority to perform marriages. In the vast majority of cases, these organizations will be essentially religious in nature.⁶ To return to the Commissioner's position, then, he states that an organization with state-delegated authority to perform marriages has no tax-exempt status concerns if it refuses to marry a same-sex couple. There are arguments for and against the Commissioner's position. Our view is that the arguments against that position are more compelling than the arguments for the position.

³ Of course, Congress could also act in the opposite manner – it could statutorily protect and preserve tax-exempt status for such organizations.

⁴ 347 U.S. 483 (1954).

⁵ For the sake of simplicity, this Note will use the term “churches” for religious institutions generally without limiting that term to Christian bodies.

⁶ In New York State leaders of organizations that are part of the American Ethical Union are also allowed to perform marriages. N.Y. DOM. REL. LAW § 11(1). Such organizations apparently claim not to be religious, at least not in the standard theological sense. *See, e.g.*, the website of the New York Society for Ethical Culture, <http://www.nysec.org/whatis> (accessed January 25, 2016).

On the negative side there is the long-held position of the Internal Revenue Service - and the courts - that an organization can be recognized as tax-exempt only if it promotes the public good. Conversely, an organization that violates the law cannot be so recognized. This “public good” doctrine has ancient roots in the laws of charity, dating as far back as the Statute of Charitable Uses in Elizabethan England. For example, in 1891, in a restatement of the English law of charity, the great English jurist Lord MacNaghten stated:

‘Charity,’ in its legal sense, comprises four principal divisions: trusts for the relief of poverty; trusts for the advancement of education; trusts for the advancement of religion; and trusts for other purposes beneficial to the community, not falling under any of the preceding heads.⁷

In the United States, as long ago as the time of the Civil War, the U.S. Supreme Court stated that:

[I]t has now become an established principle of American law that courts of chancery will sustain and protect . . . a gift . . . to public charitable uses, provided the same is consistent with local laws and public policy. . . .⁸

In another very old Supreme Court decision there is the statement that:

A charitable use, where neither law nor public policy forbids, may be applied to almost any thing that tends to promote the well-doing and well-being of social man.⁹

The flip side of the “public good” principle is that a charity may not engage in illegal activities or violate public policy.¹⁰ When the Government grants exemptions or allows deductions all taxpayers are affected; other taxpayers can be said to be indirect donors. Charitable exemptions are justified on the basis that the exempt entity confers a public benefit -- a benefit which the society or the community may not itself choose or be able to provide, or which supplements and advances the work of public institutions already supported by tax revenues.¹¹

The foregoing line of authorities was the bedrock on which the decision in the Supreme Court’s *Bob Jones University* decision rested. The interested reader is referred to the case itself for a comprehensive discussion of the history of tax-exempt status for schools with racially discriminatory admissions policies (as well as for a fuller discussion of the history of the “public good”/illegality doctrine discussed above). The condensed history, sufficient for present purposes, is that despite the decision in *Brown v. Board of Education*, the Internal Revenue Service did not exactly leap into action with an examination of tax-exempt status for schools that essentially flouted *Brown*. After some litigation, the Internal Revenue Service came around to the position in 1970 that it could “no longer legally justify allowing tax-exempt status [under Code Section 501(c)(3)] to private schools which practice racial discrimination.”¹² At the same time, the Internal Revenue Service announced that it could not treat gifts to such schools as charitable

⁷ *Commissioners v. Pemsel*, [1891] A. C. 531, 583.

⁸ *Perin v. Carey*, 24 How. 465, 501 (1861).

⁹ *Ould v. Washington Hospital for Foundlings*, 95 U.S. 303, 311 (1877).

¹⁰ See *Perin*, *supra*. See also Restatement (Second) of Trusts § 377, Comment c (1959).

¹¹ See also *Synanon Church v. United States*, USDC D.C., Civ. Action No. 82-2303 (alleged illegal acts included conspiracy to commit murder, assault and battery, and the covering-up of those activities).

¹² *Bob Jones University* (citing to an Internal Revenue Service News Release, July 7, 1970, that no longer appears to be publicly available but which is reproduced in the record of the case).

deductions for income tax purposes.¹³ Thereafter the Internal Revenue Service began notifying private schools, including those involved in the *Bob Jones University* case, of that change. This became the formal ruling position of the Internal Revenue Service in Ruling 71-447.¹⁴

As part of the Internal Revenue Service's awakening on the subject, it revoked the tax-exempt status of Bob Jones University, a Christian school in South Carolina, that banned interracial dating on theological grounds. Other schools also suffered revocation, one of which was a plaintiff in a companion case decided at the same time, Goldsboro Christian Schools. The case eventually reached the Supreme Court, which upheld the revocation – retroactive to the 1970 news release.

Bob Jones University had asserted, and the Supreme Court did not dispute, that it genuinely believed that the Bible forbids interracial dating and marriage. The sincerely held religious belief of Bob Jones University did not prevent the loss of its tax-exempt status, although the University vigorously argued that case. Acknowledging that the Free Exercise clause of the Constitution provides substantial protection for lawful conduct grounded in religious belief, the Court nevertheless concluded that:

Not all burdens on religion are unconstitutional. . . . The state may justify a limitation on religious liberty by showing that it is essential to accomplish an overriding governmental interest.

The Court concluded that in the case of race discrimination, the governmental interest in preventing it was so compelling as to override religious based conduct. Sincerely held religious beliefs have likewise bowed to compelling federal interests in other cases. Federal courts have repeatedly rejected religious freedom based claims outlawing substances such as marijuana and peyote into the United States, notwithstanding an apparent judicial recognition that a given accused might sincerely believe the use of such drugs has a proper place in certain religious ceremonies which are prescribed in both the Koran and the Bible.¹⁵

Given the *Bob Jones University* decision, and the long line of prior precedent on tax-exempt status being tied to promoting the public good and not violating the law, how can an organization that refuses to acknowledge a Constitutional right be tax-exempt? What are the arguments in support of the Commissioner's position?

One point of distinction could be based on the fact that Bob Jones University, Goldsboro Christian Schools and the other educational institutions affected by the 1983 decision were schools, not churches. Churches benefit from a panoply of distinct protections in the area of tax-exempt status not available to other tax-exempt

¹³ *Id.*

¹⁴ 1971-2 C.B. 230.

¹⁵ See *United States v. Spears*, 443 F. 2d 895 (5th Cir. 1971), and cases therein cited.

organizations.¹⁶ The Religious Freedom Restoration Act of 1993,¹⁷ passed long after the *Bob Jones University* decision, further bolsters those protections.

A second point of distinction is that it can be argued that the “public policy” principle is inapplicable because the constitutional right to same-sex marriage affirmed by *Obergefell* stops short of the a “public policy.” That seems like a very, very narrow parsing of what constitutes “public policy.” It is true that at this time there is no federal law barring discrimination on the basis of sexual orientation, and that the Supreme Court has not yet declared sexual orientation issues to be subject to the same “strict scrutiny” as race discrimination. That view can be argued, but seems like an incredibly slender reed.

A third point of distinction is the rule that certain tax-exempt status disqualifying activities, if “insubstantial,” may not cause loss of tax-exempt status. For example, in General Counsel Memorandum 34631 (October 4, 1971) the Internal Revenue Service addressed the tax-exempt status of organizations that violated local pollution regulations. The organization’s tax-exempt status survived on the rationale that while these were indeed violations of law, they were “insubstantial” in nature. So while violations of local pollution regulations may not be inconsistent with Section 501(c)(3) status if that is an “insubstantial” portion of the organization’s activities, if “only a small fraction” of an organization’s activities is robbing banks, it would not be exempt. This is insubstantial in amount, but substantial in nature. It could be argued that performing/recognizing marriages is only an “insubstantial” part of the activities of churches and most religious organizations. An “insubstantiality” argument by contrast would have been very difficult for racially discriminatory private schools as such policies appear to color virtually all the activities of schools.

I. PRIVATE ACTIONS TO ENFORCE *OBERGEFELL* IN THE TAX-EXEMPTION CONTEXT

Waiting for the Internal Revenue Service to act, however, it will be somewhere between very difficult and impossible for private persons to cause the Internal Revenue Service to act in this matter, or to seek themselves to cause the courts to act, because they will likely lack standing to do so. In order to have standing, a plaintiff must allege a fairly direct injury. Cases on the issue of standing to challenge tax-exempt status have uniformly held that the Internal Revenue Service’s recognition of an organization’s status as tax-exempt does not demonstrate sufficient direct injury so as to confer standing.

The leading case on private persons having standing to challenge tax-exempt status is *Simon v. Eastern Kentucky Welfare Rights Organization*.¹⁸ In that case certain indigent persons challenged Internal Revenue Service Ruling 69-545,¹⁹ which allows tax-exempt hospitals to deny admission to non-emergency indigent patients. The plaintiffs in *Eastern Kentucky Welfare* alleged that they had not been able to obtain hospital care because they

¹⁶ In addition to generally being exempt from the requirement to formally apply for recognition of tax-exempt status, I.R.C. § 508, and exempt from the requirement to file annual reports on Internal Revenue Service Form 990, I.R.C. § 6033, Code Section 7611 makes it extraordinarily difficult for the Internal Revenue Service to conduct examinations of churches. Essentially, this may only happen if a high-level Treasury official reasonably believes, on the basis of facts and circumstances recorded in writing, that an organization claiming to be a church or convention or association of churches may not qualify for exemption. Thus, if Commissioner Koskinen does not believe that *Obergefell* has an impact on exemption, a Code Section 7611 inquiry is essentially impossible.

¹⁷ Pub. L. No. 103-141, 107 Stat. 1488.

¹⁸ 426 U.S. 26 (1976).

¹⁹ 1969-2 C.B. 117.

could not pay, and argued that hospitals that denied indigent non-emergency care should be ineligible for tax-exempt status.

The Supreme Court held that the plaintiffs lacked the standing to challenge the Internal Revenue Service's standards for tax-exempt hospitals. The Court believed that the plaintiffs had failed to establish that the denial of their treatment was fairly traceable to Revenue Ruling 69-545. The Court reasoned that, in the absence of such evidence, "[i]t is purely speculative whether the denials of service . . . fairly can be traced to [Internal Revenue Service's] 'encouragement' or instead result from decisions made by the hospitals without regard to the tax implications."

Subsequently, in the case of *Abortion Rights Mobilization v. U.S. Conference of Catholic Bishops*,²⁰ a federal circuit court held that the plaintiff did not have standing to sue the Internal Revenue Service over what the plaintiff claimed was the agency's failure to enforce the prohibition on intervention in political campaigns – a clear, generally vigorously enforced,²¹ and explicitly statutory requirement²² for tax-exempt status. Once again, the plaintiff could not show the requisite direct injury so as to possess standing.

Even in the case of the racially discriminatory private schools, which ultimately lost their tax-exempt status through the *Bob Jones University* decision, private efforts to persuade a court to revoke their tax-exempt status failed through lack of standing attributable to a lack of direct injury.²³

II. CONGRESSIONAL ACTION AS AN APPROACH TO TAX-EXEMPT STATUS

Congress has from time to time made revisions to the requirements for tax-exempt status in Code Section 501 to deal with scenarios where it believed those standards were in need of refinement. For example, Code Section 501(c)(3) itself was amended in 1954 to add the prohibition on political activities discussed above.²⁴ Code Section 501(e) was added in 1968 to limit the availability of tax exempt status for organizations that provide certain hospital services on a co-operative basis.²⁵ Code Section 501(r), which provides that most hospitals are ineligible for tax-exempt status unless they meet certain additional requirements relating to community health needs assessments, financial assistance policies, billing and collections, was added to the Code in 2013. The approach of Code Section 501(r) is perhaps most relevant here, in that it came about in response to a Congressional sense that the standards articulated for tax-exempt status of hospitals in Revenue Ruling

²⁰ 885 F.2d 1020 (2d Cir. 1989).

²¹ See, e.g., [https://www.irs.gov/Charities-&-Non-Profits/Charitable-Organizations/The-Restriction-of-Political-Campaign-Intervention-by-Section-501\(c\)\(3\)-Tax-Exempt-Organizations](https://www.irs.gov/Charities-&-Non-Profits/Charitable-Organizations/The-Restriction-of-Political-Campaign-Intervention-by-Section-501(c)(3)-Tax-Exempt-Organizations) (accessed January 25, 2016).

²² An organization is described in Code Section 501(c)(3) only if, among other things, it "does not participate in, or intervene in (including the publishing or distributing of statements), any political campaign on behalf of (or in opposition to) any candidate for public office."

²³ *Allen v. Wright*, 468 U.S. 437 (1984).

²⁴ See James S. Ganther, *The Political Activity Restrictions of I.R.C. Section 501(c)(3) and Why They Must Go*, 4 NOTRE DAME J.L. ETHICS & PUB. POL'Y 193 (1990).

²⁵ See James Peirce Tuthill, *Qualifying As a Tax Exempt Cooperative Hospital Service Organization*, 50 NOTRE DAME L. REV. 448 (1975).

69-545 were inadequate and yet the Internal Revenue Service had not dealt with those inadequacies.²⁶

III. CONCLUSION

Although there are arguments for and against Commissioner Koskinen's response to Attorney General Pruitt, the authors' view is that on balance, the arguments against it are stronger than those in favor of it. However, the Internal Revenue Service cannot be compelled to change its position by private persons, and until either the Internal Revenue Service changes its view or Congress amends Code Section 501, the Commissioner's reply to Attorney General Pruitt is likely to stand as "right."

²⁶ A comprehensive discussion of the history and rationale of Code Section 501(r) can be found in Zachary J. Buxton, *Community Benefit 501(R)edux: An Analysis Of The Patient Protection And Affordable Care Act's Limitations Under Community Benefit Reform*, 7 ST. LOUIS U. J. HEALTH L. & POL'Y 449 (2014).