CHAPTER 1

Introduction to the U.S. Constitution and Nonprofit Law

The United States Constitution does not make any reference to nonprofit organizations. This is not surprising: The Constitution is a sketch of the structure and functioning of the federal government and its relationship with the states, not a framework for the entirety of U.S. society. Nonetheless, the Supreme Court, since issuance of its first opinion in 1791, has considerably shaped nonprofit law.

§ 1.1 Overview of Relevant Portions of the Constitution

The Constitution of the United States provides two groupings of constitutional law relevant to the development of nonprofit law: (1) appropriate portions of the original Constitution and (2) appropriate provisions added by adoption of the Bill of Rights and thereafter. Congress, on September 28, 1787, directed that the Constitution be transmitted to the state legislatures to in turn be submitted to a convention of delegates. The last of the then-existing states to ratify the Constitution did so on May 29, 1790. The first 10 amendments were properly ratified on December 15, 1791. The Fourteenth Amendment was declared in force on July 28, 1868, the Sixteenth Amendment was declared in force on February 25, 1913, and the Nineteenth Amendment was declared in force on August 26, 1920.

(a) Relevant Portions of the Original Constitution

Four articles of the original Constitution are relevant to the development of nonprofit law.

Article I. Section 1 of Article I of the Constitution established the U.S. Congress (the vesting of the legislative authority in the federal government). Section 2 concerns the creation, composition, and functions of the House of Representatives. Section 3 concerns the creation, composition, and functions of the Senate. Section 7 requires that all bills for raising revenue originate in the House. Section 8 authorizes Congress to impose taxes and to regulate commerce among the states.

Article II. Section 1 of Article II of the Constitution established the U.S. presidency (the vesting of the executive authority in the federal government).

Article III. Section 1 of Article III of the Constitution established the federal judicial system. It provides for a Supreme Court and such "inferior" courts as Congress may establish. Section 2 describes the cases to which this judicial authority extends.

Article VI. Article VI of the Constitution makes it clear that the Constitution and the federal laws "made in Pursuance thereof" are the "supreme Law of the Land."

(b) Relevant Portions of Amendments

Five articles added to the Constitution, including those adopted by ratification of the Bill of Rights (the first ten of these amendments), are relevant to the development of nonprofit law.

Article I. Article I of the Bill of Rights amendments (First Amendment) contains four pertinent provisions. One, Congress may not make any law "respecting an establishment of religion" (the Establishment Clause). Two, Congress may not make any law "prohibiting the free exercise" of religion (the Free Exercise Clause). These two clauses are collectively referred to as the Religion Clauses. Three, Congress may not make any law "abridging the freedom of speech" (the Free Speech Clause). Congress may not make any law restricting the right to "petition the Government for a redress of grievances."

Article V. Article V of these amendments (Fifth Amendment) provides for the "due process of law" (Due Process Clause). The right of due process is imposed on the states by means of Article XIV of these amendments (Fourteenth Amendment).

Article XIV. In addition to the right of due process at the state level, the Fourteenth Amendment provides that a state may not "deny to any person within its jurisdiction the equal protection of the laws" (Equal Protection Clause).

Article XVI. Article XVI of these amendments (Sixteenth Amendment) made constitutional the federal income tax. This article states that Congress has the power to "lay and collect taxes on incomes, from whatever source derived, without apportionment among the several states, and without regard to any census or enumeration."

Article XIX. Article XIX of these amendments (Nineteenth Amendment) provides that the "right of citizens of the United States to vote shall not be denied or abridged by the United States or by any State on account of sex."

§ 1.2 Role of the Supreme Court and Basic Principles

A full understanding of the role of the Supreme Court first entails an understanding of the federal court system, which in turn requires placement of all this in the context of the principle of *separation of powers*. The concept and operation of the separation of powers in the national government have their principal foundation in the first three articles of the Constitution.[1]

(a) Principle of Separation of Powers

As the court majority in the health reform law opinion (see §§ 4.8 and 8.2) explained, in the U.S. federal system, the national government possesses limited powers; the states and the people retain the remainder. Rather than granting general authority to perform all the conceivable functions of government, the U.S. Constitution enumerates the federal government's powers. The Constitution's express conferral of some

[1] See § 1.1(a).

powers makes clear that it does not grant others. The federal government can exercise only the powers granted to it. The Court wrote: "If no enumerated power authorizes Congress to pass a certain law, that law may not be enacted, even if it would not violate any of the express prohibitions in the Bill of Rights or elsewhere in the Constitution."

The same does not apply to the states, because the Constitution is not the source of their power. The Constitution may restrict state governments—as it does, for example, by forbidding them to deny any person the equal protection of the laws. But where these prohibitions do not apply, state governments do not need constitutional authorization to act. This general power of government, possessed by the states but not by the federal government, is known as the *police power*.

As to the federal court system, Article III § 1 of the Constitution commands that the "Judicial Power of the United States, shall be vested in one supreme Court, and in such inferior Courts as the Congress may from time to time ordain and establish." That article further provides that the judges of these courts shall hold their offices as long as they engage in good behavior, without diminution of salary. These courts are known as *Article III courts*.[2]

As to the matter of separation of powers, Article III is an "inseparable element of the constitutional system of checks and balances" that "both defines the power and protects the independence of the Judicial Branch."[3] Under the "basic concept of separation of powers . . . that flow[s] from the scheme of a tripartite government" adopted in the Constitution, the judicial power of the United States "can no more be shared" with another branch than the "Chief Executive, for example, can share with the Judiciary the veto power, or the Congress share with the Judiciary the power to override a Presidential veto."[4]

(b) Role of the Judiciary

The Court has "recognized that the three branches are not hermetically sealed from one another."[5] Nonetheless, "it remains true that Article III imposes some basic limitations that the other branches may not transgress."[6] These limitations serve two related purposes; one is this: "Separation-of-powers principles are intended, in part, to protect each branch of government from incursion by the others. Yet the dynamic between and among the branches is not the only object of the Constitution's concern. The structural principles secured by the separation of powers protect the individual as well."[7]

The other purpose is this: "Article III protects liberty not only through its role in implementing the separation of powers, but also by specifying the defining

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[2] Not all federal courts are Article III courts. For example, bankruptcy courts and the U.S. Tax Court are not Article III courts because their judges are periodically appointed. Thus, for example, after a bankruptcy court exercised the judicial power of the United States by entering final judgment on a common law tort claim, even though the judges of such courts enjoy neither tenure during good behavior nor salary protection, and had the statutory authority to do so, the Court ruled that the court lacked the "constitutional authority" to do so. Stern v. Marshall, 131 S. Ct. 2594, 2620 (2011).

[3] Northern Pipeline Construction Co. v. Marathon Pipe Line Co., 458 U.S. 50, 58 (1982).

[4] United States v. Nixon, 418 U.S. 683, 704 (1974).

[5] Stern v. Marshall, 131 S. Ct. 2594, 2609 (2011), citing Nixon v. Administrator of General Services, 433 U.S. 425, 443 (1977).

[6] Stern v. Marshall, 131 S. Ct. 2594, 2609 (2011).

[7] Bond v. United States, 131 S. Ct. 2355, 2365 (2011).

characteristics of Article III judges."[8] This article "could neither serve its purpose in the system of checks and balances nor preserve the integrity of judicial decisionmaking if the other branches of the Federal Government could confer the Government's 'judicial Power' on entities outside Article III."[9] It has been long recognized that, in general, Congress may not "withdraw from judicial cognizance any matter which, from its nature, is the subject of a suit at the common law, or in equity, or admiralty."[10] When a suit is made of the "stuff of the traditional actions at common law tried by the courts at Westminster in 1789,"[11] and is "brought within the bounds of federal jurisdiction, the responsibility for deciding that suit rests with Article III judges in Article III courts."[12] The Constitution assigns that role—resolution of the "mundane as well as the glamorous, matters of common law and statute as well as constitutional law, issues of fact as well as issues of law" to the federal judiciary.[13]

In one instance, Congress conferred the judicial power outside Article III over certain counterclaims in bankruptcy.[14] That may seem like a mundane transgression of the separation-of-powers principle; the Court asked if that was really a threat to the principle and answered its question: "The short but emphatic answer is yes. A statute may no more lawfully chip away at the authority of the Judicial Branch than it may eliminate it entirely."[15] Earlier, the Court wrote: "Slight encroachments create new boundaries from which legions of power can seek new territory to capture."[16] Also, although "[i]t may be that it is the obnoxious thing in its mildest and least repulsive form," the Court cannot overlook the intrusion, in that "illegitimate and unconstitutional practices get their first footing in that way, namely, by silent approaches and slight deviations from legal modes of procedure."[17] The Court, much later, wrote: "We cannot compromise the integrity of the system of separated powers and the role of the Judiciary in that system, even with respect to challenges that may seem innocuous at first blush."[18]

Pursuant to Article III, the federal judiciary is vested with the "Power" to resolve not questions and issues but "Cases" and "Controversies." This language restricts the federal judicial power to the "traditional role of the Anglo-American courts."[19] The Court wrote that, "[i]n the English legal tradition, the need to redress an injury resulting from a specific dispute taught the efficacy of judicial resolution and gave legitimacy to judicial decrees."[20] And: "The importance of resolving specific cases was visible, for example, in the incremental approach of the common law and in equity's consideration of exceptional circumstances."[21] The framers paid heed to these lessons, writing that the "judicial Power shall extend to all Cases, in Law and Equity."[22]

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[8] Stern v. Marshall, 131 S. Ct. 2594, 2609 (2011).
[9] *Id.*
[10] Murray's Lessee v. Hoboken Land & Improvement Co., 18 How. 272, 284 (1856).
[11] Northern Pipeline Construction Co. v. Marathon Pipe Line Co., 458 U.S. 50, 90 (1982).
[12] Stern v. Marshall, 131 S. Ct. 2594, 2609 (2011).
[13] Northern Pipeline Construction Co. v. Marathon Pipe Line Co., 458 U.S. 50, 86–87, n. 39 (1982).
[14] See *supra* note 9.
[15] Stern v. Marshall, 131 S. Ct. 2594, 2620 (2011). The Court termed this "one isolated respect" (*id.*).
[16] Reid v. Covert, 354 U.S. 1, 39 (1957).
[17] Boyd v. United States, 116 U.S. 616, 635 (1886).
[18] Stern v. Marshall, 131 S. Ct. 2594, 2620 (2011).
[19] Summers v. Earth Island Institute, 555 U.S. 488, 492 (2009).
[20] Arizona Christian School Tuition Organization v. Winn, 131 S. Ct. 1436, 1441 (2011).
[21] *Id.*
[22] U.S. Constitution, Art. III § 2.

By rules consistent with the longstanding practices of Anglo-American courts, a plaintiff who seeks to invoke the federal judicial power must assert more than just the "generalized interest of all citizens in constitutional governance."[23]

"Continued adherence to the case-or-controversy requirement of Article III maintains the public's confidence in an unelected but restrained Federal Judiciary," the Court wrote.[24] If the judicial power were "extended to every question under the constitution," federal courts might take possession of "almost every subject proper for legislative discussion and decision."[25] The Court added that the legislative and executive departments of the federal government, "no less than the judicial department, have a duty to defend the Constitution."[26]

Thus, the role of the Supreme Court and, within the bounds of its guidance, the other courts is this (the standard of judicial review): "It is emphatically the province and duty of the judicial department to say what the law is."[27] (Commentators are fond of noting that the concept—or power—of judicial review is not explicitly authorized by the Constitution.) Thus, if a statute and the Constitution both "apply to a particular case," and if there is an issue as to whether the statutory law is "in opposition to" the Constitution, the "court must determine which of these conflicting rules governs the case"—"[t]his is of the very essence of judicial duty."[28]

Another pronouncement from the Court on the point is this: "The judicial authority to determine the constitutionality of laws, in cases and controversies, is based on the premise that the 'powers of the legislature are defined and limited; and that these

[23] Schlesinger v. Reservists Committee to Stop the War, 418 U.S. 208, 217 (1974).

[24] Arizona Christian School Tuition Organization v. Winn, 131 S. Ct. 1436, 1442 (2011).

[25] DaimlerChrysler Corp. v. Cuno, 547 U.S. 332, 341 (2006), quoting from 4 Papers of John Marshall 95 (C. Cullen ed. 1984). The Court added: "If a dispute is not a proper case or controversy, the courts have no business deciding it, or expounding the law in the course of doing so" (*id.*). Also Weinberger v. Salfi, 422 U.S. 749 (1975) (addressing a statutory bar to jurisdiction).

[26] American Christian School Tuition Organization v. Winn, 131 S. Ct. 1436, 1442 (2011), referencing U.S. Constitution, Art. VI, cl. 3.

[27] Marbury v. Madison, 5 U.S. (1 Cranch) 137, 177 (1803). Another perspective on this point is that the "task [of the Court] is to rule on what the law is, not what it might eventually be." Garcia v. Texas, 131 S. Ct. 2866, 2867 (2011) (where the Court refused to stay the execution of a Mexican citizen, despite the president's plea for a delay to enable Congress to pass legislation to facilitate hearings on whether the rights of this individual under the Vienna Convention were denied, writing that the "Due Process Clause does not prohibit a State from carrying out a lawful judgment in light of unenacted legislation that might someday authorize a collateral attack on that judgment" (*id.*).

[28] Marbury v. Madison, 5 U.S. (1 Cranch) 137, 177 (1803). Of course, there can be controversy and disagreement in connection with a court's decree. One example is the Court's order in 2011 requiring the state of California to release from prison, due to overcrowding, thousands of convicted criminals, leading to a dissent characterizing the order as "perhaps the most radical injunction issued by a court in our Nation's history" (Brown v. Plata, 131 S. Ct. 1910, 1950 (2011)). The dissent added that, to achieve this "outrageous result," the Court, on that occasion, "disregards stringently drawn provisions of the governing statute, and traditional constitutional limitations upon the power of a federal judge, in order to uphold the absurd" (at 1950–1951). There is more: The "proceedings that led to this result were a judicial travesty" and the dissent was written "because the institutional reform the District Court has undertaken violates the terms of the governing statute, ignores bedrock limitations on the power of Article III judges, and takes federal courts wildly beyond their institutional capacity" (at 1951).

limits may not be mistaken, or forgotten, the constitution is written.'"[29] An appellate court added that the "judiciary is called upon not only to interpret the laws, but at times to enforce the Constitution's limits on the power of Congress, even when that power is used to address an intractable problem."[30]

That shared obligation of the three branches of the federal government is incompatible with the suggestion that federal courts might wield an "unconditioned authority to determine the constitutionality of legislative or executive acts."[31] The Court wrote: "For the federal courts to decide questions of law arising outside of cases and controversies would be inimical to the Constitution's democratic character."[32] Also, the resulting conflict between the judicial and the other two branches (what the Court has termed the "political branches"[33]) would not, "in the long run, be beneficial to either."[34] The Court takes care to observe the "role assigned to the judiciary" within the Constitution's "tripartite allocation of power."[35]

Thus, the courts are far from general policymaking bodies. This fact was recently evidenced in a Supreme Court case concerning the drawing of state electoral maps.[36] The legislature of a state, which has experienced population growth to the point of entitlement to four additional seats in the U.S. House of Representatives, had drawn such maps, only to have a federal district court revise them, to accommodate the state's 2012 primary and general elections. The problem facing the judiciary is that the pre-existing arrangement provides no suggestion as to where these new congressional districts should be placed. The Court observed that, if the "old" state districts plan was the "only source to which a district court could look, it would be forced to make the sort of policy judgments for which courts are, at best, ill suited."[37] The Court wrote that, "[t]o avoid being compelled to make such otherwise standardless decisions, a district court should take guidance from the State's recently enacted plan in drafting an interim plan," inasmuch as the legislature's plan "reflects the State's policy judgments on where to place new districts and how to shift existing ones in response to [the state's] massive population growth."[38] The Court concluded: "To the extent the District Court exceeded its mission to draw interim maps that do not violate the Constitution or the Voting Rights Act, and substituted its own concept of 'the collective public good' for the [state's] [l]egislature's determination of which policies serve 'the interests of the citizens of' [the state], the court

[29] City of Boerne v. Flores, 521 U.S. 507, 516 (1997), quoting Marbury v. Madison, 5 U.S. (1 Cranch) 137, 176 (1803).
[30] Florida v. Dept. of Health & Human Servs., 648 F.3d 1235, 1282–1283 (11th Cir. 2011).
[31] Valley Forge Christian College v. Americans United for Separation of Church & State, Inc., 454 U.S. 464, 471 (1982). As to the matter of courts declaring acts of Congress unconstitutional, see § 1.2 (c), text accompanied by *infra* notes 46–47. In a letter from the Office of the U.S. Attorney General to judges on an appellate court, dated April 5, 2012 (Attorney General letter), it was stated that the "power of the courts to review the constitutionality of legislation is beyond dispute," citing Free Enterprise Fund v. Public Company Accounting Oversight Board, 130 S. Ct. 3138 (2010); FCC v. Beach Communications, Inc., 508 U.S. 307 (1993).
[32] Arizona Christian School Tuition Organization v. Winn, 131 S. Ct. 1436, 1442 (2011).
[33] *Id.*
[34] United States v. Richardson, 418 U.S. 166, 188–189 (1974).
[35] Valley Forge Christian College v. Americans United for Separation of Church and State, Inc., 454 U.S. 464, 474 (1982) (internal quotation marks omitted).
[36] Perry v. Perez, 132 S. Ct. 934 (2012).
[37] *Id.* at 941.
[38] *Id.*

erred."[39] It added: "Because the District Court here had the benefit of a recently enacted plan to assist it, the court had neither the need nor the license to cast aside that vital aid."[40]

It is out of this sweeping panorama of the separation of powers that the doctrine of standing[41] emerged. The Court portrayed this evolution:

> *Few exercises of the judicial power are more likely to undermine public confidence in the neutrality and integrity of the Judiciary than one which casts the Court in the role of a Council of Revision, conferring on itself the power to invalidate laws at the behest of anyone who disagrees with them. In an era of frequent litigation, class actions, sweeping injunctions with prospective effect, and continuing jurisdiction to enforce judicial remedies, courts must be more careful to insist on the formal rules of standing, not less so. Making the Article III standing inquiry all the more necessary are the significant implications of constitutional litigation, which can result in rules of wide applicability that are beyond Congress' power to change.*[42]

A federal district wrote that "Article III standing is a fundamental constitutional requirement that prevents courts from unnecessarily reaching legal issues in situations where the party to the litigation has failed to allege an injury which triggers an actual case or controversy that needs resolution by the courts."[43] A federal court of appeals observed that, "to support standing, the plaintiff's injury must be actual or imminent to ensure that the court avoids deciding a purely hypothetical case in which the projected harm may ultimately fail to occur."[44] This appellate court subsequently stated that the "reasoning behind the imminence requirement is to ensure that the court avoids deciding a purely hypothetical case in which the projected harm may ultimately fail to occur."[45]

(c) Role of the Supreme Court

One of the functions of the Court is to ascertain the constitutionality of an Act of Congress. This is the "gravest and most delicate duty that this Court is called upon to perform."[46] The Court, like other courts, is often called on to make "fine distinctions" between "what is and what is not absolute under the Constitution;" "it is an essential

[39] *Id.* at 943.
[40] *Id.*
[41] See § 8.12.
[42] Arizona Christian School Tuition Organization v. Winn, 131 S. Ct. 1436, 1449 (2011).
[43] Butler v. Obama, 814 F. Supp. 2d 230, 235 (E.D.N.Y. 2011).
[44] Baur v. Veneman, 352 F.3d 625, 632 (2nd Cir. 2003).
[45] Connecticut v. American Electric Power Co., 582 F.3d 309, 343 & n. 19 (2nd Cir. 2009) (internal quotation marks omitted). This court also wrote that, "[b]ecause [the plaintiff] alleges only a potential for [injury] that has not yet occurred and because that potential is born of nothing more than hypothesis and conjecture, [the plaintiff] lacks standing" (Brito v. Mukasey, 521 F.3d 160, 168 (2nd Cir. 2008)). As a judge wrote, "[a]lthough [a] plaintiff may view standing as a malleable procedural obstacle that can be quickly cast aside to address an interesting and important constitutional [law] issue, that is not the law" (Butler v. Obama, 814 F. Supp. 2d 230, 234–235 (E.D.N.Y. 2011)).
[46] Blodgett v. Holden, 275 U.S. 142, 147–148 (1927).

part of adjudication to draw distinctions, including fine ones, in the process of interpreting the Constitution."[47]

Congressional enactments are entitled to a "presumption of constitutionality" and are to be invalidated only in the case of a "plain showing that Congress has exceeded its constitutional bounds."[48] The presumption that a provision of law is constitutionally valid is "not a mere polite gesture" but is a "deference due to deliberate judgment by constitutional majorities of the two Houses of Congress that an Act is within their delegated power."[49]

The Court, however, often rules on the meaning or application of a statute without addressing the statute's constitutionality. For example, in 2009, eight members of the Court agreed to decide a case on statutory grounds instead of reaching the appellant's broader argument that the statute in question is unconstitutional.[50] Indeed, in accordance with the Court's adherence to the principle of *judicial restraint*, the latter approach is the preferred approach.

Thus, the present chief justice of the Court wrote that, "[b]ecause the stakes are so high, our standard practice is to refrain from addressing constitutional [law] questions except when necessary to rule on particular claims before us."[51] That is what happened in connection with the 2010 decision striking down as unconstitutional, in violation of free speech principles, a statutory ban on corporate political speech—the Court analyzed, and rejected, each of the appellant's statutory claims before proceeding to constitutional law adjudication.[52] This policy "underlies both [the Court's] willingness to construe ambiguous statutes to avoid constitutional problems"[53] and its practice "never to formulate a rule of constitutional law broader than is required by the precise facts to which it is to be applied."[54]

Thus, having rejected the statutory claims in the 2010 case, the Court first considered the appellant's narrowest constitutional law claim (which was rejected) before proceeding to the broadest constitutional law claim, which was that a previously decided case should be overruled (which is what the Court did).[55] In another case, the appellant prevailed on its narrowest constitutional law argument, eliminating the

[47] Walz v. Tax Comm'n of City of New York, 397 U.S. 664, 679 (1970). The Attorney General letter stated: "Where a plaintiff properly invokes the jurisdiction of a court and presents a justiciable challenge, there is no dispute that courts properly review the constitutionally of Acts of Congress."

[48] United States v. Morrison, 529 U.S. 598, 607 (2000). Also Turner Broadcasting System, Inc. v. FCC, 507 U.S. 1301 (1993). The Court wrote that a "congressional judgment" at issue in a case was "entitled to a strong presumption of validity" (Gonzales v. Raich, 545 U.S. 1, 28 (2005)). It also held that, in light of this presumption of constitutionality, it falls to the party seeking to overturn a federal law to show that it is clearly unconstitutional" (Salazar v. Buono, 130 S. Ct. 1803 (2010)).

[49] United States v. Five Gambling Devices, 346 U.S. 441, 449 (1953). The Court also stated: "Respect for a coordinate branch of Government forbids striking down an Act of Congress except upon a clear showing of unconstitutionality" (Salazar v. Buono, 130 S. Ct. 1803, 1820 (2010)).

[50] Northwest Austin Municipal Utility District No. One v. Holder, 129 S. Ct. 2504 (2009).

[51] Citizens United v. Federal Election Comm'n, 130 S. Ct. 876, 918 (2010) (concurring opinion), citing Ashwander v. Tennessee Valley Authority, 297 U.S. 288, 346–348 (1936).

[52] Citizens United v. Federal Election Comm'n, 130 S. Ct. 876, 888–892 (2010).

[53] *Id.* at 918.

[54] United States v. Raines, 362 U.S. 17, 21 (1960), quoting from Liverpool, New York & Philadelphia S.S. Co. v. Comm'rs of Emigration, 113 U.S. 33, 39 (1885).

[55] Citizens United v. Federal Election Comm'n, 130 S. Ct. 876, 892–899 (2010).

need for the Court to address its broader claim (which was that an earlier decision should be overruled).[56]

Nonetheless, from time to time, the Court reaches the conclusion that a constitutional law analysis is unavoidable. The present chief justice posited this "false premise": The Court's "practice of avoiding unnecessary (and unnecessarily broad) constitutional holdings somehow trumps our obligation faithfully to interpret the law."[57] He added: "It should go without saying, however, that we cannot embrace a narrow ground of decision simply because it is narrow; it must also be right."[58] The dissent in the same case quoted an appellate court opinion, where the court wrote that "if it is not necessary to decide more, it is necessary not to decide more."[59] The chief justice retorted that, while that statement is true, "sometimes it *is* necessary to decide more," observing that "[t]here is a difference between judicial restraint and judicial abdication."[60] He added: "When constitutional questions are 'indispensably necessary' to resolving the case at hand, the Court 'must meet and decide them.'"[61]

In the health reform c majority opinion, the Court wrote: "Members of this Court are vested with the authority to interpret the law; we possess neither the expertise nor the prerogative to make policy judgments. These decisions are entrusted to our Nation's elected leaders, who can be thrown out of office if the people disagree with them. It is not our job to protect the people from the consequences of their political choices." Yet the Court added that "[o]ur deference in matters of policy cannot, however, become abdication in matters of law." "[T]here can be no question that it is the responsibility of this Court to enforce the limits on federal power by striking down acts of Congress that transgress those limits."

Consequently, not every decision by the Supreme Court involves an interpretation of the U.S. Constitution; often, a decision of the Court is a statement as to what the law is, irrespective of constitutional law principles. Court decisions involving nonprofit law are likely to be of the latter variety, such as those articulating the scope of tax exemption,[62] invoking the public policy doctrine,[63] launching the commerciality doctrine,[64] construing the unrelated business rules,[65] interpreting tax regulations,[66] or defining the terms *gift*,[67] or *scholarship*.[68] Nonetheless, when a nonprofit law opinion of the Court involves construction of the Constitution, the results can be spectacular; examples of this are the opinion freeing up millions of dollars for expenditure in connection with political campaigns, with much of this money flowing to tax-exempt organizations, on free speech grounds[69]; the trilogy of opinions striking down state or municipal constraints on charitable fundraising, also on the basis of

[56] Federal Election Comm'n v. Wisconsin Right to Life, Inc., 551 U.S. 449, 482–483 (2007).
[57] Citizens United v. Federal Election Comm'n, 130 S. Ct. 876, 919 (2010) (concurring opinion).
[58] *Id.*
[59] *Id.* at 937, quoting from PDK Laboratories., Inc. v. Drug Enforcement Admin., 362 F.3d 786, 799 (D.C. Cir. 2004) (concurring opinion).
[60] Citizens United v. Federal Election Comm'n, 130 S. Ct. 876, 919 (2010) (emphasis by the Court).
[61] *Id.*, quoting from Ex parte Randolph, 20 F. Cas. 242, 254 (No. 11, 558) (CC Va. 1833).
[62] See § 1.6.
[63] See § 1.8.
[64] See § 1.10.
[65] See § 8.4.
[66] See § 8.1.
[67] See § 8.5.
[68] See § 8.6.
[69] See § 5.6.

free speech principles[70]; and, of course, the opinion finding the individual health insurance mandate to be constitutional as a valid exercise of Congress's power to lay and collect taxes.[71]

(d) Policy of *Stare Decisis*

Closely related to the principle of judicial restraint is the policy of *stare decisis*, the latter being, as the present chief justice wrote, "[f]idelity to precedent."[72] This policy, he wrote, is "vital to the proper exercise of the judicial function."[73] The Court earlier observed: "*Stare decisis* is the preferred course because it promotes the evenhanded, predictable, and consistent development of legal principles, fosters reliance on judicial decisions, and contributes to the actual and perceived integrity of the judicial process."[74] For these reasons, the Court has "long recognized that departures from precedent are inappropriate in the absence"[75] of a "special justification."[76]

At the same time, *stare decisis* is neither an "inexorable command"[77] nor a "mechanical formula of adherence to the latest decision,"[78] especially in constitutional law cases.[79] "If it were," wrote the chief justice, "segregation would be legal, minimum wages laws would be unconstitutional, and the Government could wiretap ordinary criminal suspects without first obtaining warrants."[80]

Stare decisis has been characterized by the Court as a "principle of policy."[81] Seventy years later, the chief justice wrote: "When considering whether to reexamine a prior erroneous holding, we must balance the importance of having constitutional questions

[70] See § 7.4(c)–(e).
[71] See § 8.2.
[72] Citizens United v. Federal Election Comm'n, 130 S. Ct. 876, 920 (2010) (concurring opinion).
[73] *Id.*
[74] Payne v. Tennessee, 501 U.S. 808, 827 (1991).
[75] Citizens United v. Federal Election Comm'n, 130 S. Ct. 876, 920 (2010).
[76] Arizona v. Rumsey, 467 U.S. 203, 212 (1984). An illustration of application of the policy of *stare decisis* in the federal tax context occurred when the Court held that the six-year statute of limitations (IRC § 6501(e)(1)(A)) is not triggered by an overstatement of basis, noting that the Court's interpretation of the identical provision in the 1939 Code (in Colony, Inc. v. Comm'r, 357 U.S. 28 (1958)) must be followed in the context of the 1954 Code inasmuch as the alternative approach would be an overruling of the earlier decision, a "course of action that basic principles of *stare decisis* wisely counsel us not to take" (United States v. Home Concrete & Supply, LLC, No. 11-139, April 25, 2012).
[77] Lawrence v. Texas, 539 U.S. 558, 577 (2003).
[78] Helvering v. Hallock, 309 U.S. 106, 119 (1940).
[79] United States v. Scott, 437 U.S. 82, 101 (1978).
[80] Citizens United v. Federal Election Comm'n, 130 S. Ct. 876, 920 (2010), referencing Plessy v. Ferguson, 163 U.S. 537 (1896), overruled by Brown v. Board of Education, 347 U.S. 483 (1954); Adkins v. Children's Hospital of D.C., 261 U.S. 525 (1923), overruled by West Coast Hotel Co. v. Parrish, 300 U.S. 379 (1937); and Olmstead v. United States, 277 U.S. 438 (1928), overruled by Katz v. United States, 389 U.S. 347 (1967).

A lengthy dissent in *Citizens United* was critical of the Court's overruling of Austin v. Michigan Chamber of Commerce, 494 U.S. 652 (1990) (Citizens United v. Federal Election Comm'n, 130 S. Ct. 876, 929–979 (2010)). The chief justice reminded the author of that dissent of his urging, in Randall v. Sorrell, 548 U.S. 230, 274–281 (2006), the Court to overrule its invalidation of limits on independent expenditures on political speech in Buckley v. Valeo, 424 U.S. 1 (1976) (Citizens United v. Federal Election Comm'n, 130 S. Ct. 876, 921 (2010)).
[81] Helvering v. Hallock, 309 U.S. 106, 119 (1940).

decided against the importance of having them *decided right*."[82] A justice wrote that this exercise requires a "sober appraisal of the disadvantages of the innovation as well as those of the questioned case, a weighing of practical effects of one against the other."[83]

The chief justice wrote that, in "conducting this balancing, we must keep in mind that *stare decisis* is not an end in itself."[84] Rather, it is the "means by which we ensure that the law will not merely change erratically, but will develop in a principled and intelligible fashion."[85] He continued: "Its greatest purpose is to serve a constitutional ideal—the rule of law. It follows that in the unusual circumstance when fidelity to any particular precedent does more to damage this constitutional ideal than to advance it, we must be more willing to depart from that precedent."[86]

Thus, for example, if the precedent under consideration departed from the Court's jurisprudence,[87] returning to the "'intrinsically sounder' doctrine established in prior cases" may "better serv[e] the values of *stare decisis* than would be following [the] more recently decided case inconsistently with the decisions that came before it."[88] The chief justice wrote that "[a]brogating the errant precedent, rather than reaffirming or extending it, might better preserve the law's coherence and curtail the precedent's disruptive effects."[89]

He continued:

> *Likewise, if adherence to a precedent actually impedes the stable and orderly adjudication of future cases, its stare decisis effect is also diminished. This can happen in a number of circumstances, such as when the precedent's validity is so hotly contested that it cannot reliably function as a basis for decision in future cases, when its rationale threatens to upend our settled jurisprudence in related areas of law, and when the precedent's underlying reasoning has become so discredited that the Court cannot keep the precedent alive without jury-rigging new and different justifications to shore up the original mistake.*[90]

(e) Facial and As Applied Challenges

There are fundamentally two types of challenges to the constitutionality of a statute. One is the *facial* challenge—a pre-enforcement attack on the provision in all its settings, as opposed to just some of them.[91] Facial challenges seek to "leave nothing

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[82] Citizens United v. Federal Election Comm'n, 130 S. Ct. 876, 920 (2010) (emphasis by the Court).
[83] Jackson, "Decisional Law and *Stare Decisis*," 30 A.B.A. Jour. 334 (1944).
[84] Citizens United v. Federal Election Comm'n, 130 S. Ct. 876, 920 (2010).
[85] Vasquez v. Hillery, 474 U.S. 254, 265 (1986).
[86] Citizens United v. Federal Election Comm'n, 130 S. Ct. 876, 921 (2010).
[87] Which is what the Court majority concluded in *Citizens United* in overruling Austin v. Michigan Chamber of Commerce, 494 U.S. 652 (1990), and what the chief justice individually concluded as explained in his concurring opinion (Citizens United v. Federal Election Comm'n, 130 S. Ct. 876, 921–925 (2010)).
[88] Adarand Constructors, Inc. v. Pena, 515 U.S. 200, 231 (1995).
[89] Citizens United v. Federal Election Comm'n, 130 U.S. 876, 921 (2010).
[90] *Id.*, citing Pearson v. Callahan, 555 U.S. 223, 233 (2009), and Montejo v. Louisiana, 129 S. Ct. 2079, 2088 (2009) (where it was written that *stare decisis* does not control when adherence to the prior decision requires "fundamentally revising its theoretical basis").
[91] An excellent and recent example of this type of challenge is in McConnell v. Federal Election Comm'n, 540 U.S. 93 (2003), where all aspects of the Federal Election Campaign Act, as amended in 2002, were challenged on a constitutional law basis. See Chapter 5.

standing"—to prevent any application of the law no matter the context, "no matter the circumstances."[92] These challenges are "disfavored" because (1) "they raise the risk of premature interpretation of statutes on the basis of factually barebones records"[93]; (2) they undermine the "fundamental principle of judicial restraint," which counsels that "courts should neither anticipate a question of constitutional law in advance of the necessity of deciding it nor formulate a rule of constitutional law broader than is required by the precise facts to which it is to be applied"[94]; and (3) they run the risk of a "judicial trespass," in which the court strikes down a law "in all of its applications even though the legislature has the prerogative and presumed objective to regulate some of them."[95] For these reasons, a facial attack is the "most difficult challenge to mount successfully," requiring the plaintiff to establish that "no set of circumstances exists under which the Act would be valid."[96]

In most constitutional law cases, the claimant challenges the constitutionality of a statute *as applied* to specific parties and circumstances.[97] This is the "preferred route" for litigation because it confines judicial review to a "discrete factual setting."[98]

The judicial-constraint values underlying this doctrine apply equally to enumerated-power cases[99] and individual-liberty cases.[100] The Supreme Court has said as much, noting that this "demanding standard" governs challenges to Congress's exercise of enumerated powers.[101] A federal judge, in a court of appeals' concurring opinion, in considering these matters in the context of a challenge to the constitutionality of the Patient Protection and Affordable Care Act's individual health insurance mandate,[102] observed: "None of this means that the distinction makes a difference in every case or with respect to every argument. Some theories of invalidity necessarily apply to all applications of a law. Others do not. This case . . . falls in the latter category, as some of plaintiffs' theories of invalidity—particularly their proposed action/inaction limitation on congressional power—do not cover many applications of the mandate."[103]

(f) Congressional Findings

The matter of congressional findings, adopted as part of enactment of legislation, also highlights the role of the judiciary in relation to the federal legislative branch. The courts, for example, look to these findings to help them "evaluate the legislative

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[92] Warshak v. United States, 532 F.3d 521, 528 (6th Cir. 2008). Also Gonzales v. Carhart, 550 U.S. 124 (2007) (holding that the respondents in the case did not demonstrate that an abortion ban act was void for vagueness or that it imposed an undue burden on a woman's right to an abortion based on its overbreadth or lack of a health exception).

[93] Washington State Grange v. Washington State Republican Party, 552 U.S. 442, 450 (2008).

[94] *Id.*

[95] Connection Distribution Co. v. Holder, 557 F.3d 321, 335 (6th Cir. 2009).

[96] United States v. Salerno, 481 U.S. 739, 745 (1987).

[97] The recent successful challenges to the constitutionality of provisions of the Federal Election Campaign Act, as amended in 2002, were brought on an as applied basis.

[98] Warshak v. United States, 532 F.3d 521, 529–530 (6th Cir. 2008).

[99] Such as those that challenged the constitutionality of the individual health insurance mandate. See §§ 4.5–4.8, 8.2.

[100] E.g., United States v. Salerno, 481 U.S. 739 (1987).

[101] Sabri v. United States, 541 U.S. 600, 604–605, 608–609 (2004). These powers are inventoried in U.S. Constitution, Art. I § 8.

[102] See §§ 4.5–4.8.

[103] Thomas More Law Center v. Obama, 651 F.3d 529, 556 (6th Cir. 2011).

judgment that the activity in question substantially affected interstate commerce."[104] Nonetheless, to continue this example, the "existence of congressional findings is not sufficient, by itself, to sustain the constitutionality of Commerce Clause legislation."[105] Rather, the Court has insisted that courts examine congressional findings regarding substantial effects on commerce. As the Court has written, "simply because Congress may conclude that a particular activity substantially affects interstate commerce does not necessarily make it so."[106]

Illustrative of how courts may treat legislative findings is an appellate court's analysis of them in connection with the debate over the constitutionality, in connection with congressional Commerce Clause power, of the Patient Protection and Affordable Care Act's individual health insurance mandate.[107] One of the government's principal arguments in that context was that the mandate is necessary, by curbing "cost-shifting" on the part of the uninsured, to the creation and maintenance of a substantial health insurance market. The court of appeals did not agree with Congress's reasoning on many points, writing that the "wholesale deference the government would have us apply here cannot be squared" with two Supreme Court decisions.[108] In one of these decisions, the Court stated that Congress's findings are "substantially weakened by the fact that they rely so heavily on a method of reasoning that [the Court has] already rejected as unworkable if we are to maintain the Constitution's enumeration of powers."[109]

The appellate court wrote that "[i]t is highly instructive that [in these two cases, the Court] rejected a similar cost-shifting theory now propounded by the government."[110] In one of these cases, concerning firearms possession,[111] in examining the relationship between gun possession and interstate commerce, the Court refused to accept what it referred to as the government's "cost of crime" theory.[112] It did so despite the government's argument that the "costs of violent crime are substantial, and, through the mechanism of insurance, those costs are spread throughout the population."[113] And: "[I]f we were to accept the Government's arguments, we are hard pressed to posit any activity by an individual that Congress is without power to regulate."[114]

In the other of these cases, concerning gender-motivated violence,[115] the Court considered congressional findings attesting to the link between domestic violence and medical costs frequently borne by third parties. In this case, the Court recounted Congress's finding that gender-motivated violence substantially affected interstate commerce by "deterring potential victims from traveling interstate, from engaging in employment in interstate business, and from transacting with business, and in places involved in interstate commerce; . . . by diminishing national productivity, increasing medical and other costs, and decreasing the supply of and the demand for interstate

[104] United States v. Lopez, 514 U.S. 549, 549 (1995). See Chapter 4.
[105] United States v. Morrison, 529 U.S. 598, 614 (2000).
[106] United States v. Lopez, 514 U.S. 549, 557, n. 2 (1995), quoting Hodel v. Virginia Surface Mining & Reclamation Ass'n, Inc., 452 U.S. 264, 311 (1981).
[107] See Chapter 4.
[108] Florida v. Dep't of Health & Human Servs., 648 F.3d 1235, 1301 (11th Cir. 2011).
[109] United States v. Morrison, 529 U.S. 598, 615 (2000).
[110] Florida v. Dep't of Health & Human Servs., 648 F.3d 1235, 1301 (11th Cir. 2011).
[111] See § 4.3(b).
[112] United States v. Lopez, 514 U.S. 549, 564 (1995).
[113] *Id.* at 563–564.
[114] *Id.* at 564.
[115] See § 4.3(c).

products."[116] The Court did not dispute the figures about medical costs but instead considered them largely extraneous to the threshold question of whether the subject matter of the legislation had a sufficient nexus to interstate commerce. It rejected the government's invitation to "follow the but-for causal chain from the initial occurrence of violent crime . . . to every attenuated effect upon interstate commerce."[117]

In both of these instances, the Court determined that the government's cost-shifting argument provided too attenuated a link to Congress's commerce power. Under this type of a cost-shifting theory, the Court wrote, it is "difficult to perceive any limitation on federal power, even in areas such as criminal law enforcement or education where States historically have been sovereign."[118]

The appellate court wrote that, "[f]or example, we harbor few doubts that an individual's decisions about 'marriage, divorce, and child custody,' if aggregated, would have substantial effects on interstate commerce."[119] "Yet," it continued, the "mere fact of an activity's substantial effects on interstate commerce does not thereby render that activity an appropriate subject for Congress's plenary commerce authority," observing that "[s]uch a holding would require the Supreme Court to overturn" these two decisions.[120]

The appellate court added that "[w]e see no reason why the inferential leaps in this case are any less attenuated than those in" the two Court cases, adding that the "cost-shifting accompanying the criminal acts of violence at issue in [those cases]—hospital bills borne by third parties, property damage and insurance consequences, law enforcement expenditures, and incarceration costs—is at least as apparent as the multi-step cost-shifting scenario associated with the medically uninsured."[121] "Meanwhile," the court continued, the "regulated conduct giving rise to the cost-shifting is divorced from a commercial transaction or the 'production, distribution, and consumption of commodities.'"[122]

The court concluded on this point by observing that, "[a]t best, we can say that the uninsured *may*, at some point in the *unforeseeable future*, create that cost-shifting consequence," adding that "[y]et this readily leads to a scenario where we must 'pile inference upon inference' to sustain Congress's legislation, a practice the Supreme Court admonishes us to avoid."[123] This court finished this analysis by writing that, "[i]f anything, the temporal aspects present here, but not in [the two Court cases], render the regulated 'activity' even *further* remote."[124]

There are, of course, instances where the Court has adhered to congressional findings. For example, the Court wrote that "we have no difficulty concluding that Congress had a rational basis for believing that failure to regulate the intrastate manufacture and possession of marijuana would leave a gaping hole in the" operative statute.[125]

[116] United States v. Morrison, 529 U.S. 598, 615 (2000).
[117] *Id.*
[118] United States v. Lopez, 514 U.S. 549, 564 (1995).
[119] Florida v. Dep't of Health & Human Servs., 648 F.3d 1235, 1302 (11th Cir. 2011), quoting United States v. Lopez, 514 U.S. 549, 564 (1995).
[120] Florida v. Dep't of Health & Human Servs., 648 F.3d 1235, 1302 (11th Cir. 2011).
[121] *Id.*
[122] *Id.*, quoting Gonzales v. Raich, 545 U.S. 1, 26 (2005).
[123] Florida v. Dep't of Health & Human Servs., 648 F.3d 1235, 1302 (11th Cir. 2011) (emphasis by the court), quoting United States v. Lopez, 514 U.S. 549, 567 (1995).
[124] Florida v. Dep't of Health & Human Servs., 648 F.3d 1235, 1302 (11th Cir. 2011).
[125] Gonzales v. Raich, 545 U.S. 1, 22 (2005).

(g) Severability

The matter of courts severing unconstitutional provisions from otherwise constitutional legislation also is reflective of the role of the courts—judicial restraint—with severability also fundamentally rooted in the respect for the principle of separation of powers. As the Supreme Court wrote, courts must "strive to salvage" acts of Congress by severing any constitutionally inform provisions "while leaving the remainder intact."[126] Indeed, the "presumption is in favor of severability."[127] The alternative, of course, is for a court to hold that the unconstitutional element of the statute is so pervasive with respect to the whole that the entire enactment must be found constitutionally deficient.[128]

In the overwhelming majority of these cases, the Supreme Court has opted to sever the constitutionally defective provision from the remainder of the statute, salvaging the latter. For example, the Court held that an unconstitutional tenure provision was severable from the Sarbanes-Oxley Act[129]; that a take-title provision was severable from the Low-Level Radioactive Waste Policy Amendments Act of 1985[130]; that a legislative veto provision was severable from the Airline Deregulation Act of 1978[131]; that a legislative veto provision was severable from the Immigration

[126] Ayotte v. Planned Parenthood of Northern New England, 546 U.S. 320, 329 (2006).

[127] Regan v. Time, Inc., 468 U.S. 641, 653 (1984). The Court wrote that it "accords 'great weight to the decisions of Congress,'" in part because Congress is a "coequal branch of government whose members take the same oath [that judges] do to uphold the Constitution of the United States" (Rostker v. Goldberg, 453 U.S. 57, 64 (1981), quoting Columbia Broadcasting System, Inc. v. Democratic Nat'l Committee, 412 U.S. 94, 102 (1973)).

[128] This happened in one of the individual health insurance mandate cases (see § 4.5), where a district court wrote that the mandate "cannot [simply] be severed" if the overall statute is "viewed as a carefully balanced and clockwork-like statutory arrangement comprised of pieces that all work toward one primary legislative goal, and if that goal would be undermined if a central part of the legislation is found to be unconstitutional" (Florida v. Dep't of Health & Human Servs., 780 F. Supp. 2d 1256, 1299 (N.D. Fla. 2011)). It stated that the "record seems to strongly indicate that Congress would not have passed the Act in its present form if it had not included the individual mandate" (*id.* at 1300–1301). This is because the mandate "was indisputably essential to what Congress was ultimately seeking to accomplish" (*id.* at 1301). The court found "strong evidence that Congress recognized the Act could not operated *as intended* without the individual mandate" (*id.*) (emphasis by the court).

The court wrote that the Act has been "analogized to a finely crafted watch, and that seems to fit" (*id.* at 1304). The court continued: "It has approximately 450 separate pieces, but one essential piece (the individual mandate) is defective and must be removed. It cannot function as originally designed. There are simply too many moving parts in the Act and too many provisions dependent (directly and indirectly) on the individual mandate and other health insurance provisions—which, as noted, were the chief engines that drove the entire legislative effort—for me to try and dissect out the proper from the improper, and the able-to-stand-alone from the unable-to-stand-alone" (*id.*).

This court concluded that the "individual mandate and the remaining provisions are all inextricably bound together in purpose and must stand or fall as a single unit" (*id.* at 1305). Returning to the watch analogy, it stated that the Act, "like a defectively designed watch, needs to be redesigned and reconstructed by the watchmaker" (*id.*).

[129] Free Enterprise Fund v. Public Company Accounting Oversight Board, 130 S. Ct. 3138 (2010).

[130] New York v. United States, 505 U.S. 144 (1992).

[131] Alaska Airlines, Inc. v. Brock, 480 U.S. 678 (1987).

and Nationality Act[132]; and that campaign expenditure limits were severable from the public financing provisions in the Federal Election Campaign Act of 1971.[133]

In the Commerce Clause context,[134] for example, the Supreme Court struck down an important provision of a statute and left the remainder of the enactment intact. In this case, the Court invalidated a civil remedies provision for victims of gender-based violence but did not invalidate the entire Violence Against Women Act or the omnibus Violent Crime Control and Law Enforcement Act of 1994, of which it was a part—even though the text of the legislation did not contain a severability clause.[135]

Thus, as these cases demonstrate, the Court has declined to invalidate more of a statute than is absolutely necessary. Rather, the Court wrote, "when confronting a constitutional flaw in a statute, we try to limit the solution to the problem."[136] Because "[a] ruling of unconstitutionality frustrates the intent of the elected representatives of the people," a court should "act cautiously" and "refrain from invalidating more of the statute than is necessary."[137]

The Court's test for severability is "well-established": "Unless it is evident that the Legislature would not have enacted those provisions which are within its power, independently of that which is not, the invalid part may be dropped if what is left is fully operative as a law."[138] As the Court remarked, divining legislative intent in the absence of a severability or non-severability clause can be an "elusive" enterprise.[139]

This matter of the appropriate severability of a legislative provision from its larger host was dramatically explored in the cases involving the individual insurance mandate enacted by the Patient Protection and Affordable Care Act.[140] In one of these cases, a district court, finding the mandate unconstitutional, invalidated the entire act.[141] On this point, the lower court was overruled, with the court of appeals holding that an excision of the mandate from the legislation would not prevent the remaining provisions from being "fully operative as a law."[142] The appellate court wrote that the "lion's share of the Act has nothing to do with private insurance, much less the mandate that individuals buy insurance," referencing "such wholly unrelated provisions" as the establishment for reasonable break time for nursing mothers, epidemiology-laboratory grants, a Department of Health and Human Services study on urban Medicare-dependent hospitals, restoration of funding for abstinence education, and an excise tax on indoor tanning salons.[143]

[132] INS v. Chadha, 462 U.S. 919 (1982).
[133] Buckley v. Valeo, 424 U.S. 1 (1976). See Chapter 5.
[134] See Chapter 4.
[135] United States v. Morrison, 529 U.S. 598 (2000). Sometimes Congress inserts in legislation a provision stating that if one or more elements of the legislation are deemed unconstitutional the balance of the legislation is not to be considered invalidated.
[136] Ayotte v. Planned Parenthood of Northern New England, 546 U.S. 320, 328 (2006).
[137] Regan v. Time, Inc., 468 U.S. 641, 652 (1984).
[138] Alaska Airlines, Inc. v. Brock, 480 U.S. 678, 685 (1987) (quotation marks omitted).
[139] INS v. Chadha, 462 U.S. 919, 932 (1982).
[140] See §§ 4.5–4.8.
[141] Florida v. Dep't of Health & Human Servs., 780 F. Supp. 2d 1256 (N.D. Fla. 2011).
[142] Florida v. Dep't of Health & Human Servs., 648 F.3d 1235, 1322 (11th Cir. 2011).
[143] *Id.* The court could have added references to the additional rules imposed on tax-exempt hospitals (IRC § 501(r)) (see *Law of Tax-Exempt Organizations* § 7.6(b)) and the tax exemption provided for nonprofit health insurance issuers (IRC § 501(c)(29)) (*id.* § 19.18).

The court of appeals wrote that "[i]n invalidating the entire Act, the district court placed undue emphasis on the Act's lack of a severability clause."[144] It stated that Supreme Court precedent confirms that the "ultimate determination of severability will rarely turn on the presence or absence of such a clause."[145] Rather, Congress's "silence is just that—silence—and does not raise a presumption against severability."[146]

In this case, the district court placed emphasis on the fact that an early version of the health law revision legislation contained a severability clause. Congress's failure to include such a clause in the final bill, the district court reasoned, "can be viewed as strong evidence that Congress recognized that the Act could not operate *as intended* without the individual mandate."[147] "But," admonished the appellate court, the district court "pushe[d] the inference too far."[148] The court reviewed the congressional drafting manuals, which showed, according to them, that the severability clause was unnecessary and its removal should not be read as an indicator of legislative intent against severability. Thus, this court concluded, the "removal of the severability clause, in short, has no probative impact on the severability question before us."[149]

The Supreme Court's majority opinion in the health care reform case did not address the law of severability in that the Court found the entirety of the legislation to be constitutional. The dissenters, however, believing the legislation unconstitutional, considered the matter of severability at some length. They first rooted their position in the separation-of-powers context, writing that the judiciary, "if it orders uncritical severance, then assumes the legislative function; for it imposes on the Nation, by the Court's decree, its own new statutory regime, consisting of policies, risks, and duties that Congress did not enact." They added: "That can be a more extreme exercise of the judicial power than striking the whole statute and allowing Congress to address the conditions that pertained when the statute was considered at the outset."

The dissent explored this "complex statute" in considerable detail, surveying the law's major provisions, the insurance rules, various taxes, reductions in reimbursements and expenditures, health insurance exchanges, and a host of minor provisions. It observed that the Court "has not previously had occasion to consider severability in the context of an omnibus enactment like the ACA, which includes not only many provisions that are ancillary to its central provisions but also many that are entirely unrelated—hitched on because it was a quick way to get them passed despite opposition, or because their proponents could exact their enactment as the quid pro quo for their needed support." The dissenters wrote that "[w]hen we are confronted with such a so-called 'Christmas tree,' a law to which many nongermane ornaments have been attached, we think the proper rule must be that when the tree no longer exists the ornaments are superfluous."

The dissent stated that the Court has "no reliable basis for knowing which pieces of the Act would have passed on their own," adding that it is "certain that many of them would not have, and it is not a proper function of this Court to guess which." The dissenters concluded the point with this: "This Court must not impose risks

[144] Florida v. Dep't of Health & Human Servs., 648 F.3d 1235, 1322 (11th Cir. 2011).
[145] United States v. Jackson, 390 U.S. 570, 585, n. 27 (1968).
[146] Alaska Airlines, Inc. v. Brock, 480 U.S. 678, 686 (1987).
[147] Florida v. Dep't of Health & Human Servs., 780 F. Supp. 2d 1256, 1301 (N. D. Fla. 2011) (emphasis by the court).
[148] Florida v. Dep't Health & Human Servs., 648 F.3d 1235, 1322 (11th Cir. 2011).
[149] *Id.* at 1323.

unintended by Congress or produce legislation Congress may have lacked the support to enact. For those reasons, the unconstitutionality of both the Individual Mandate and the Medicaid Expansion requires the invalidation of the Affordable Care Act's other provisions."

§ 1.3 Concept of the Nonprofit Organization

The Supreme Court has written very little about nonprofit organizations as such. Indeed, the Court has defined the term only once—in a Commerce Clause case (rather than a corporate or tax law case as might be assumed).[150] A review of what the Court wrote in this regard will be prefaced by a generic look at this fundamental precept—the concept of the *nonprofit organization*.

The term *nonprofit organization* does not mean an organization that is prohibited by law from earning a profit (that is, an excess of gross earnings over expenses). In fact, it is quite common for nonprofit (and tax-exempt) organizations to generate profits. Rather, the definition of nonprofit organization essentially relates to requirements as to what must be done with the profit earned or otherwise received. This fundamental element of the law is subsumed in the doctrine of private inurement.[151]

This concept in law of a nonprofit organization is best understood through a comparison with the concept of a *for-profit* organization. A fundamental distinction between the two types of entities is that the for-profit organization has owners that hold the equity in the enterprise, such as stockholders of a corporation. The for-profit organization is operated for the economic benefit of its owners; the profits of the business undertaking are passed through to them, such as by the payment of dividends on shares of stock. That is what is meant by the term *for-profit organization*: It is an entity that is designed to generate a profit for its owners. The transfer of the profits from the organization to its owners is private inurement—the inurement of net earnings to them in their private (personal) capacity. For-profit organizations are expected to engage in forms of private inurement.

By contrast, a nonprofit organization is not permitted to distribute its profits (net earnings) to those who control it, such as directors and officers. That is why the private inurement doctrine is the substantive defining characteristic that distinguishes nonprofit organizations from for-profit organizations for purposes of the law. There are thus two categories of profit: one is at the *entity* level and one is at the *ownership* level. Both nonprofit and for-profit organizations can yield entity-level profit; the distinction in law between the two types of entities pivots on the latter category of profit.

§ 1.4 Doctrine of Private Inurement

The doctrine of private inurement is one of the most important sets of rules constituting the federal law of nonprofit organizations. This doctrine is a statutory criterion for federal income tax exemption for several categories of exempt organizations, including charitable entities.

[150] See § 1.6. Also Chapter 3.
[151] See § 1.4.

The private inurement doctrine requires that a tax-exempt organization subject to it be organized and operated so that, in antiquated language, "no part of . . . [its] net earnings . . . inures to the benefit of any private shareholder or individual." What this doctrine means is that none of the income or assets of a tax-exempt organization subject to the private inurement doctrine may be permitted to directly or indirectly unduly benefit an individual or other person who has a close relationship with the organization when that person is in a position to exercise a significant degree of control over the entity.

The purpose of the private inurement rule is to ensure that the tax-exempt organization involved is serving exempt rather than private interests. It is thus necessary for an organization subject to the doctrine to be in a position to establish that it is not organized and operated for the benefit of persons in their private capacity, informally referred to as *insiders*, such as the organization's founders, trustees, directors, officers, members of their families, entities controlled by these individuals, or any other persons having a personal and private interest in the activities of the organization.

The doctrine of private inurement does not prohibit transactions between a tax-exempt organization subject to the doctrine and those who have a close relationship with it. Rather, the private inurement doctrine requires that these transactions be tested against a standard of *reasonableness*. The standard calls for a roughly equal exchange of benefits between the parties; the law is designed to discourage a disproportionate share of the benefits of the exchange flowing to an insider.

The private inurement doctrine does not prohibit the payment of compensation to employees of a charitable organization, provided the compensation is reasonable and not excessive. The reasonableness standard focuses essentially on comparability of data—that is, how similar organizations, acting prudently, transact their affairs in comparable instances. Thus, the regulations pertaining to the business expense deduction, addressing the matter of the reasonableness of compensation, provide that it is generally just to assume that reasonable and true compensation is only such amount as would ordinarily be paid for like services by like enterprises under like circumstances.[152]

The sanction for violation of the private inurement doctrine is revocation (or denial) of the tax-exempt status of the organization involved.

§ 1.5 The Supreme Court's Definition of *Nonprofit Organization*

The Supreme Court's one and only foray into the realm of defining the term *nonprofit organization* occurred in a case interpreting the reach of the Commerce Clause.[153]

The Court wrote that a "nonprofit entity is ordinarily understood to differ from a for-profit corporation principally because it 'is barred from distributing its net earnings, if any, to individuals who exercise control over it, such as members, officers, directors, or trustees.'"[154]

The Supreme Court's definition of the term *nonprofit organization* is not far off the mark. The matter of *control*, however, is not confined to *individuals* (although ultimately a transaction or arrangement involving private inurement always entails

[152] Income Tax Regulations (Reg.) § 1.162-7(b)(3).

[153] See Chapter 3.

[154] Camps Newfound/Owatonna, Inc. v. Town of Harrison, 520 U.S. 564, 585 (1997). The internal quote is from Hansmann, "The Role of Nonprofit Enterprise," 89 *Yale L. J.* 835, 838 (1980).

something done by one or more individuals); control of a nonprofit organization can also be exercised by organizations (such as corporations, partnerships, trusts, and estates). Additionally, the Court's definition of *nonprofit organization* is somewhat too narrow in that the requisite insider can be a person who *is in a position to* exercise control over the entity (that is, actual control is not necessary to cause a person to be an insider).

Three nitpicks about the Court's definition. One, it is rare that an organization's *members* have sufficient control (or potential for control) over the affairs of a nonprofit organization.[155] Two, there is *deemed control*, in that control persons (insiders) also include members of the family of directors, trustees, and the like, and further include entities that control them. Three, it is not clear what the words "ordinarily understood" mean in the context of this definition; consideration of the concept of *nonprofit organization* is not an undertaking that is *ordinarily* undertaken and the definition is what it is, so the word *understood* seems extraneous.

One other note about the Court's definition. Consider the word *principally*. The Court did not explain the import of the presence of this word but presumably it reflects the fact that, pursuant to the statutory law in most states, a nonprofit organization is, in addition to avoiding private inurement, required to adhere to purposes and engage in activities represented by words such as charitable, philanthropic, benevolent, and eleemosynary.

§ 1.6 The Supreme Court's View as to Eligibility for Tax Exemption

Notwithstanding the Supreme Court's meager efforts to define the term *nonprofit organization*, the Court has had, and continues to have, a huge impact on the availability of tax exemption for these organizations, all because of one decision—involving a chapter of the Better Business Bureau.[156] The *Better Business Bureau* opinion, authored in 1945, has been cited by courts and the IRS more frequently, in the nonprofit law context, than any other court opinion.

In many instances, the federal statutory law providing for a tax exemption states that an organization must, to qualify for the exemption, be organized and operated *exclusively* for the exempt purpose.[157] Courts have repeatedly held that this requirement is not to be read literally; that is, the word *exclusively* is a term of art and should be interpreted to mean *primarily*.[158] The Supreme Court has led the way in this regard, stating, in the context of federal tax exemption for charitable organizations, that the "presence of a single . . . [nonexempt] purpose, if substantial in nature, will destroy the exemption regardless of the number or importance of truly . . . [exempt] purposes."[159]

The Court, in this case, considered the eligibility for tax exemption, as an educational entity, of a chapter of the Better Business Bureau. The Court found

[155] Nonetheless, the IRS frequently finds instances of private inurement being conferred on the members of a tax-exempt organization, often without discussion as to whether any of the members are insiders (see § 1.4).

[156] Better Business Bureau of Washington, D.C. v. United States, 326 U.S. 279 (1945).

[157] E.g., IRC § 501(c)(3), where the statute reads that, to be tax-exempt, the organization must be organized and operated *exclusively* for charitable and like purposes, and meet other requirements.

[158] See *Law of Tax-Exempt Organizations* § 4.4.

[159] Better Business Bureau of Washington, D.C. v. United States, 326 U.S. 279, 283 (1945).

a non-educational purpose in the form of promotion of a community of for-profit businesses; this purpose, the Court held, precluded tax exemption. The Court, in the closest it has come to expressly articulating the commerciality doctrine,[160] wrote that the organization seeking exemption had a "commercial hue" and that its activities were "largely animated by this commercial purpose."[161]

§ 1.7 The Supreme Court's Rationale for Tax Exemption

The Supreme Court has infrequently ruminated about the rationale for tax exemptions for nonprofit organizations. One of the more significant of these instances occurred in connection with a case concerning the constitutionality of a state's real estate tax exemption, in relation to the Religion Clauses of the First Amendment, which encompassed the real property of religious organizations.[162] The majority opinion in this case focused primarily on the constitutionality of this tax exemption, because of the exemption accorded to churches and other religious entities,[163] but it contains observations about exemption for nonprofit organizations generally.

The real estate tax exemption at issue came into being, wrote the Court, because the state, "in common with the other States, . . . determined that certain entities that exist in a harmonious relationship to the community at large, and that foster its 'moral or mental improvement,' should not be inhibited in their activities by property taxation or the hazard of loss of those properties for nonpayment of taxes."[164] The state granted exemption with respect to a "broad class of property owned by nonprofit, quasi-public corporations which include hospitals, libraries, playgrounds, scientific, professional, historical, and patriotic groups."[165] The Court continued: "The State has an affirmative policy that considers these groups as beneficial and stabilizing influences in community life and finds this classification useful, desirable, and in the public interest."[166] Also: "Qualification for tax exemption is not perpetual or immutable; some tax-exempt groups lose that status when their activities take them outside the classification and new entities can come into being and qualify for exemption."[167]

In a concurring opinion, it was written that a "range" of "private, nonprofit" organizations "contribute to the well-being of the community in a variety of nonreligious ways, and thereby bear burdens that would otherwise either have to be met by general taxation, or be left undone, to the detriment of the community."[168] This justice stated that nonprofit groups that receive tax exemption contribute to the "diversity of association, viewpoint, and enterprise essential to a vigorous, pluralistic society."[169]

Another concurring opinion referred to a "class of nontaxable entities whose common denominator is their nonprofit pursuit of activities devoted to cultural and moral improvement and the doing of 'good works' by performing certain social

[160] See § 1.10.
[161] Better Business Bureau of Washington, D.C. v. United States, 326 U.S. 279, 283–284 (1945).
[162] Walz v. Tax Comm'n of City of New York, 397 U.S. 664 (1970).
[163] See § 2.6(a).
[164] Walz v. Tax Comm'n of City of New York, 397 U.S. 664, 672 (1970).
[165] *Id.* at 673.
[166] *Id.*
[167] *Id.*
[168] *Id.* at 687.
[169] *Id.* at 689.

services in the community that might otherwise have to be assumed by government."[170] The justice added that tax exemptions for nonprofit organizations "are an institution in themselves, so much so that they are . . . expected and accepted as a matter of course."[171]

§ 1.8 Public Policy Doctrine

The Supreme Court ruled that tax exemption as a charitable organization is available only where the organization—even if it is meeting the statutory requirements[172]—is operating in conformity with federal public policy.[173] This rule of law, a judicially imposed overlay of the statutory law, is known as the *public policy doctrine*.

(a) Basic Principles

Authority for the public policy doctrine is traceable to a 1958 Supreme Court opinion, holding that tax benefits such as deductions and exclusions generally are subject to limitation on public policy grounds.[174] At issue in that case was the deductibility of fines as ordinary and necessary business expenses.[175] The Court held that an expense is not *necessary* to the operation of a business if allowance of a tax deduction would "frustrate sharply defined national or state policies proscribing particular types of conduct, evidenced by some governmental declaration thereof."[176]

The Court subsequently adopted the view that the purpose of a charitable entity "may not be illegal or violate established public policy."[177] It was written that "[h]istory buttresses logic to make clear that, to warrant [tax] exemption under § 501(c)(3), an institution must . . . demonstrably serve and be in harmony with the public interest" and not have a purpose that is "so at odds with the common community conscience as to undermine any public benefit that might otherwise be conferred."[178] The Court added that "determinations of public benefit and public policy are sensitive matters with serious implications for the institutions affected" and that a "declaration that a given institution is not 'charitable' should be made only where there can be no doubt that the activity involved is contrary to a fundamental public policy."[179]

In a concurring opinion, a justice stated that he was "troubled by the broader implications of the Court's opinion," finding it "impossible to believe that all or even

[170] *Id.* at 696.
[171] *Id.* at 698.
[172] IRC § 501(c)(3).
[173] Bob Jones Univ. v. United States, 461 U.S. 574 (1983).
[174] Tank Truck Rentals, Inc. v. Comm'r, 356 U.S. 30 (1958).
[175] The deduction at issue was available pursuant to the predecessor of IRC § 162(a).
[176] Tank Truck Rentals, Inc. v. Comm'r, 356 U.S. 30, 33 (1958).
[177] Bob Jones Univ. v. United States, 461 U.S. 574, 591 (1983).
[178] *Id.* at 591–592.
[179] *Id.* at 592. Earlier, the Court wrote that the federal income tax is a "tax on net income, not a sanction against wrongdoing" and that the "statute does not concern itself with the lawfulness of the income it taxes" (Comm'r v. Tellier, 383 U.S. 687, 691 (1966)).

The Court, in articulating this aspect of the public policy doctrine, rested its determination on the precept that all of the types of organizations referenced in IRC § 501(c)(3) must meet "certain common law standards of charity" (Bob Jones Univ. v. United States, 461 U.S. 574, 586 (1983)), in large part because of the overlap of the charitable giving deduction rules.

most of . . . [tax-exempt charitable] organizations could prove that they 'demonstrably serve and [are] in harmony with the public interest' or that they are 'beneficial and stabilizing influences in community life.'"[180] Quoting other portions of the majority opinion that impart the "element of conformity that appears to inform the Court's analysis," this justice wrote that "these passages suggest that the primary function of a tax-exempt organization is to act on behalf of the Government in carrying out governmentally approved policies."[181] Moreover, he disassociated himself from the majority by being "unwilling to join any suggestion that the Internal Revenue Service is invested with authority to decide which public policies are sufficiently 'fundamental' to require denial of tax exemptions."[182]

The public policy doctrine applicable to tax-exempt charitable organizations was articulated in the context of racial discrimination by exempt public schools.[183] Surprisingly, the reach of this doctrine has not been extensive; instances of its application have been infrequent. In one case, the government contended that an organization was ineligible for exemption because it engaged in violent and illegal activities; although the case was dismissed, the court concluded that the doctrine could have been applied in the case had the court decided the matter on its merits.[184] On another occasion, a court revoked the exemption of an organization, finding a violation of the doctrine in its "[conspiracy] to impede the IRS in performing its duty to determine and collect taxes" from the organization, in contravention of federal criminal laws."[185]

The IRS occasionally applies the rule that an organization must satisfy the public policy test to qualify for tax exemption as a charitable organization. For example, in determining whether activities such as demonstrations, economic boycotts, strikes, and picketing are permissible means for furthering charitable ends, the IRS adheres to the public policy doctrine.[186] An organization formed by a violent sexual predator to sexually exploit children by promoting repeal of child pornography and exploitation laws was found by the IRS to have a purpose that is "contrary to public policy to protect the sexual exploitation of children."[187]

(b) Race-Based Discrimination

The Supreme Court held that private schools may not racially discriminate, and be tax-exempt and eligible for deductible charitable contributions.[188] This conclusion was expressly made applicable to all nonprofit private schools, including those that engage in racial discrimination on the basis of religious beliefs. As to religious schools, the Court found that the "governmental interest at stake here is compelling" and that this interest substantially outweighs the burden the denial of tax benefits places on the schools' exercise of their religious beliefs.[189]

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[180] *Id.* at 606, 609.
[181] *Id.* at 609.
[182] *Id.* at 611.
[183] See § 1.8(b).
[184] Synanon Church v. United States, 579 F. Supp. 967 (D.D.C. 1984), *aff'd*, 820 F.2d 421 (D.C. Cir. 1987).
[185] Church of Scientology of California v. Comm'r, 83 T.C. 381 (1984), *aff'd*, 823 F.2d 1310 (9th Cir. 1987).
[186] IRS General Counsel Memorandum 37858.
[187] Priv. Ltr. Rul. 200909064. This position of the IRS was upheld in court (Mysteryboy Incorporation v. Comm'r, 99 T.C.M. 1057 (2010)).
[188] Bob Jones Univ. v. United States, 461 U.S. 574 (1983).
[189] *Id.* at 604.

The Court majority unabashedly adopted a public policy argument. The Court found in the "Congressional purposes" underlying this tax exemption "unmistakable evidence" of an "intent that entitlement to tax exemption depends on meeting certain common law standards of charity—namely, that an institution seeking tax-exempt status must serve a public purpose and not be contrary to established public policy."[190]

As to the requisite public policy involved in this context, the Court concluded that "there can no longer be any doubt that racial discrimination in education violates deeply and widely accepted views of elementary justice."[191] "It would be wholly incompatible with the concepts underlying tax exemption," held the Court, to "grant the benefit of tax-exempt status to racially discriminatory educational entities."[192] The Court added: "Whatever may be the rationale for such private schools' policies, and however sincere the rationale may be, racial discrimination in education is contrary to public policy."[193]

The Court confronted the fact that Congress, while it clearly has the authority to revise the statutory law on the subject, has not done so. Congress, held the Court, had known about the posture of the IRS in these regards for a dozen years[194] and thus had acquiesced in and had implicity ratified IRS rulings in 1970 and 1971.[195] The Court cited the failure by Congress to enact bills that would statutorily override the IRS position as providing "added support for concluding that Congress acquiesced in" the IRS determinations.[196] Moreover, the Court concluded that the enactment by Congress of anti-discrimination rules in 1976, applicable to tax-exempt social clubs,[197] represented that Congress "affirmatively manifested its acquiescence in the IRS policy" pertaining to private schools.[198]

(c) Gender-Based Discrimination

While there is a recognized federal public policy against support for racial segregation in private schools (and against racial discrimination in other exempt organizations settings[199]), a somewhat comparable federal public policy against support for private institutions[200] that engage in gender-based discrimination may be developing.[201] The question is whether this is a sufficiently established federal policy so that

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[190] *Id.* at 586.
[191] *Id.*
[192] *Id.* at 595.
[193] *Id.*
[194] The IRS had taken the position since 1967 that private educational institutions may not, to be tax-exempt, have racially discriminatory policies, and issued a revenue ruling on the point in 1972 and guidelines and record-keeping procedures in a revenue procedure in 1972. See *Law of Tax-Exempt Organizations* § 6.2(b)(ii).
[195] Bob Jones Univ. v. United States, 461 U.S. 574, 598–602 (1983).
[196] *Id.* at 601.
[197] IRC § 501(i). See *Law of Tax-Exempt Organizations* § 4.8(b).
[198] Bob Jones Univ. v. United States, 461 U.S. 574, 601–602 (1983).
[199] E.g., Crenshaw County Private School Found. v. Connally, 474 F.2d 1185 (3rd Cir. 1973), *cert. den.*, 417 U.S. 908 (1973).
[200] Where the educational institution is operated by a government, the operation of it exclusively for the members of one gender is likely to be a violation of the equal protection doctrine (e.g., the operation by the Commonwealth of Virginia of the military college, Virginia Military Institute, exclusively for males) (United States v. Virginia, 518 U.S. 515 (1996)).
[201] E.g., McGlotten v. Connally, 388 F. Supp. 448 (D.D.C. 1972).

its contravention would have an impact on the tax status of these institutions and other charitable organizations.[202] The issue has been raised, with courts concluding that sex discrimination does not bar federal tax exemption.[203] A court, however, having concluded that the charitable contribution deduction is equivalent to a federal matching grant, found that by allowing the deduction of charitable contributions, the federal government has conferred a "benefit" on the recipient organization and that the equal protection guarantees of the Fifth Amendment are applicable.[204]

Nonetheless, the Supreme Court determined that a national nonprofit membership organization is compelled to accept women as regular members, by direction of a state human rights act, notwithstanding the organization's free speech and associational rights.[205] This organization's chapters were found to be "place[s] of public accommodations," the skills it develops were held to be "goods," and business contacts and employment promotions were ruled to be "privileges" and "advantages"—all so that the state's law banning gender-based discriminatory practices in access to places of public accommodation could be made applicable.[206]

(d) Affirmative Action Principles

Tax-exempt organizations are often involved in affirmative action efforts, with benefits decisions based on race, gender, and the like, such as preferential social assistance and scholarship and award programs, designed to, in the words of the Supreme

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[202] E.g., Executive Order 11246, as amended, 30 Fed. Reg. 12319 (1965); Title VII of the Civil Rights Act of 1964, as amended, 42 U.S.C. § 2000e *et seq.*; Equal Employment Opportunity Comm'n regulations, 29 C.F.R. § 1604 *et seq.*; Title IX of the Education Amendments of 1972, 20 U.S.C. § 1681 *et seq.*; the Equal Pay Act of 1963, 29 U.S.C. § 206 *et seq.*; Califano v. Webster, 430 U.S. 313 (1977) (upholding a statute that operated to compensate women for past economic discrimination by allowing them to eliminate low-earning years from the calculation of their retirement benefits); Alexander v. Louisiana, 405 U.S. 625 (1972) (where the petitioner's contentions regarding discrimination against women in a selection of grand jurors was not reached, although the petitioner made out a prima facie case of invidious discrimination in the selection of the grand jury that indicted him); Reed v. Reed, 404 U.S. 71 (1971) (holding a mandatory provision of a state's probate code that gave preference to men over women when individuals of the same entitlement class apply for appointment as administrator of a decedent's estate to be based solely on a form of discrimination that is violative of equal protection principles).

[203] McCoy v. Shultz, 73-1 U.S.T.C. ¶ 9233 (D.D.C. 1973); Junior Chamber of Commerce of Rochester, Inc. v. United States Jaycees, Inc., 495 F.2d 883 (10th Cir. 1974), *cert. den.*, 419 U.S. 1026 (1974); New York City Jaycees, Inc. v. United States Jaycees, Inc., 512 F.2d 856 (2nd Cir. 1975).

[204] McGlotten v. Connally, 338 F. Supp. 448, 456–457, note 37 (D.D.C. 1972). Also Stearns v. Veterans of Foreign Wars, 500 F.2d 788 (D.C. Cir. 1974) (remand).

[205] Roberts, Acting Comm'r, Minnesota Dep't of Human Rights v. United States Jaycees, 468 U.S. 609 (1984). See § 1.9.

[206] *Id.* Also New York State Club Ass'n v. New York City, 487 U.S. 1 (1987) (holding that a club association has standing to challenge the constitutionality of a local law on behalf of its members, inasmuch as they would have standing to sue in their own right); Board of Directors of Rotary Int'l v. Rotary Club of Duarte, 481 U.S. 537 (1987) (where a state law that entitles all individuals, regardless of gender, to equal accommodations, advantages, facilities, privileges, and services in all business establishments in the state was held to not be violative of the First Amendment by requiring state Rotary Clubs to admit women). Cf. Trustees of Smith College v. Board of Assessors of Whately, 434 N.E.2d 182 (Mass. 1982) (where a private college's single-sex admissions policy was successfully defended).

Court, "remedy disadvantages cast on minorities by past racial [or other] prejudice."[207] The dilemma in law, of course, with these policies is potential conflict with the public policy doctrine[208]; the Court also observed that "preferring members of any one group for no reason other than race or ethnic origin is discrimination for its own sake."[209] Nonetheless, courts and the IRS have recognized, in the exempt organizations context, the distinction between *discrimination against* and *discrimination for the benefit of* groups of individuals. The former is what can be banned by the public policy doctrine; the latter can be tolerated as forms of *affirmative action*.

From a law standpoint, in addition to considerations as to impact on an organization's tax-exempt status, discrimination based on race can involve invocation of the equal protection doctrine, Title VI of the Civil Rights Act of 1964,[210] and the Civil Rights Act of 1866.[211] One of the touchstone principles in this constitutional law setting is whether a government has a substantial *state interest* in conducting a program where race is an element as to classification or distribution of benefits; the law developed in this regard provides guidance as to the forms of discrimination that are permissible in the larger context. Another fundamental principle is that racial classifications reviewable pursuant to equal protection considerations must be strictly scrutinized; the Supreme Court wrote that "any person, of whatever race, has the right to demand that any governmental actor subject to the Constitution justify any racial classification subjecting that person to unequal treatment under the strictest of judicial scrutiny."[212] The Court stated that the "guarantee of equal protection cannot mean one thing when applied to an individual and something else when applied to a person of another color," that is, "[i]f both are not accorded the same protection, then it is not equal."[213]

These competing principles have been examined by the Court in connection with admissions policies of public colleges and universities that are based, with varying degrees of emphasis, on race.[214] The Court reviewed a race-based set-aside program that reserved 16 out of 100 seats in a public university's medical school class for members of certain minority groups. The Court held that a state has a "substantial interest that legitimately may be served by a properly devised admissions program involving the competitive consideration of race and ethnic origin,"[215] thereby establishing what has appeared to be the fundamental principle that a public college or university may, in the operation of an admissions program, consider the race of applicants.

Subsequently, the Court upheld an admissions program of a public university's law school that considered race and ethnicity as "plus" factors affecting diversity, with a goal of attaining a "critical mass" of underrepresented minority students.[216] In this controversial case, the Court emphasized that a "race-conscious admissions program [of a public university] cannot use a quota system—it cannot 'insulate each

[207] Regents of Univ. of California v. Bakke, 438 U.S. 265, 325 (1978).
[208] See § 1.8(a).
[209] Regents of Univ. of California v. Bakke, 438 U.S. 265, 307 (1978).
[210] 42 U.S.C. § 2000e.
[211] 42 U.S.C. § 1981.
[212] Adarand Constructors, Inc. v. Pena, 515 U.S. 200, 224 (1995).
[213] Regents of Univ. of California v. Bakke, 438 U.S. 265, 289–290 (1978).
[214] As it happens, another clash of constitutional law principles occurs in the education context, by reason of academic freedom, which "long has been viewed as a special concern of the First Amendment" (*id.* at 314).
[215] *Id.* at 320.
[216] Grutter v. Bollinger, 539 U.S. 306, 316, 321 (2003).

category of applicants with certain desired qualifications from competition with all other applicants.'"[217] Indeed, in a companion case, the Court found that a public university's undergraduate admissions policy, based on a system that automatically granted points to underrepresented minority individuals, was not narrowly tailored to achieve the university's asserted compelling interest in diversity; the policy was held to violate equal protection principles.[218] Nonetheless, the Court stated that "[e]ven remedial race-based governmental action generally 'remains subject to continuing oversight to assure that it will work the least harm possible to other innocent persons competing for the benefit.'"[219]

The rationale underlying these decisions to allow public institutions to take race into account, as part of the admissions process, is the promotion of diversity in academia. It is common today for public and private schools to include race and ethnicity as factors in determining admissions. The Court, however, has agreed to hear a case that may lead to a decision banning the use of race-based admissions policies by public institutions and also by private ones (by application of the Civil Rights Act).[220] Oral arguments in this case are likely to occur in late 2012.

In practice, the principles enunciated in the context of admissions programs of institutions of higher education are not always followed by tax-exempt organizations. As noted, exempt organizations often conduct race-based, gender-based, and similar affirmative action programs. On occasion, affirmative action can be a primary purpose of an entity. For example, a court, in a fluid recovery case,[221] ordered the design of a scholarship program by which grants were to be awarded to African-American high school students residing in two states.[222] The IRS ruled that an organization formed to conduct an apprentice training program offering instruction in a skilled trade was a tax-exempt charitable entity, even though the beneficiaries of its educational activities were confined to Native Americans.[223] Likewise, the IRS approved a scholarship program established by a private foundation, where these grants are required to be made on an "objective and nondiscriminatory basis,"[224] even though all the grantees were students at a boys-only school.[225]

Nonetheless, in a Civil Rights Act of 1866 case,[226] a federal appellate court held that the admissions policy of a tax-exempt private school, which operated in practice as an absolute bar to admission to the school for those of a "non-preferred race," constituted unlawful race discrimination.[227] The lower court had concluded that the

[217] *Id.* at 334, quoting from Regents of the Univ. of California v. Bakke, 438 U.S. 265, 315 (1978).
[218] Gratz & Hamacher v. Bollinger, 539 U.S. 244 (2003).
[219] Grutter v. Bollinger, 539 U.S. 306, 341 (2003), quoting from Regents of the Univ. of California v. Bakke, 438 U.S. 265, 308 (1978).
[220] Fisher v. Univ. of Texas at Austin, *cert. gr.*, 132 S. Ct. 1536 (2012).
[221] See *Law of Tax-Exempt Organizations* § 6.3(g).
[222] Powell v. Georgia-Pacific Corp., 119 F.3d 703 (8th Cir. 1997), aff'g, 843 F. Supp. 491 (W.D. Ark. 1994).
[223] Rev. Rul. 77-272, 1977-2 C.B. 191.
[224] IRC § 4945(g)(1).
[225] Priv. Ltr. Rul. 200603029. The policy of the IRS has long been that, where the effect of a race-based focus or limitation in an exempt organization's program reduces the effects of discrimination, or lack of education or opportunity, the preference is allowable, that is, it is not contrary to public policy.
[226] See text accompanied by *supra* note 210.
[227] Doe v. Kamehameha Schools/Bernice Pauahi Bishop Estate, 416 F.3d 1025, 1027 (8th Cir. 2005).

admissions policy constituted a valid race-conscious remedial affirmative action program.[228] Nonetheless, following a review of this case by its full panel, this court of appeals held that the school's "preferential admissions policy is designed to counteract the significant, current educational deficits of Native Hawaiian children in Hawaii," that is, is an affirmative action program, and consequently concluded that the school's admissions policy is "valid" under the Civil Rights Act.[229]

It is thus clear that this aspect of the constitutional, civil rights, and federal tax law remains unsettled. The most that can be said is that tax-exempt organizations that engage in affirmative action programs should be prepared for ongoing strict scrutiny of their efforts, including the ability to articulate a compelling interest for taking this approach. The decision from the Court, expected in early 2013, concerning race-based affirmative action admissions programs of public colleges and universities, will have a huge impact on the viability of these programs and may well force a significant change in policy.

§ 1.9 Freedom of Association Principle

Tax exemption for nonprofit membership organizations may be viewed as a manifestation of the constitutionally protected right of association accorded the members of these organizations. (This is the closest the U.S. Constitution comes to referencing nonprofit organizations.) There are two types of *freedom of association.* One type—termed the *freedom of intimate association*—is the traditional type of protected association derived from the right of personal liberty. The other type—the *freedom of expressive association*—is a function of the right of free speech protected by the First Amendment to the Constitution.

By application of the doctrine of freedom of intimate association, the formation and preservation of certain types of highly personal relationships are afforded a substantial measure of sanctuary from interference by government.[230] These personal bonds are considered to foster diversity and advance personal liberty.[231] In assessing the extent of constraints on the authority of government to interfere with this freedom, a court must make a determination of where the objective characteristics of the relationship, which is created where an individual enters into a particular association, are located on a spectrum from the most intimate to the most attenuated of personal relationships.[232] Relevant factors include size, purpose, policies, selectivity, and congeniality.[233]

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[228] Doe v. Kamehameha Schools/Bernice Pauahi Bishop Estate, 295 F. Supp. 2d 1141 (D. Haw. 2003).

[229] Doe v. Kamehameha Schools/Bernice Pauahi Bishop Estate, 470 F.3d 827, 849 (9th Cir. 2006). The plaintiffs sought Supreme Court review of this decision but the case was settled before the Court ruled on the petition for certiorari.

[230] Pierce v. Society of Sisters, 268 U.S. 510 (1925); Meyer v. Nebraska, 262 U.S. 390 (1923).

[231] Zablocki v. Redhail, 434 U.S. 374 (1978); Quilloin v. Walcott, 434 U.S. 246 (1978); Smith v. Organization of Foster Families, 431 U.S. 816 (1977); Carey v. Population Servs. Int'l, 431 U.S. 678 (1977); Moore v. East Cleveland, 431 U.S. 494 (1977); Cleveland Board of Education v. LaFleur, 414 U.S. 632 (1974); Wisconsin v. Yoder, 406 U.S. 205 (1973); Stanley v. Illinois, 405 U.S. 645 (1972); Stanley v. Georgia, 394 U.S. 557 (1969); Griswold v. Connecticut, 381 U.S. 479 (1965); Olmstead v. United States, 277 U.S. 438 (1928).

[232] Runyon v. McCrary, 427 U.S. 160 (1976).

[233] Roberts, Acting Comm'r, Minnesota Dep't of Human Rights v. United States Jaycees, 468 U.S. 609 (1984).

The freedom to engage in group effort is guaranteed under the doctrine of freedom of expressive association[234] and is viewed as a way of advancing political, social, economic, educational, religious, and cultural ends.[235] Government, however, has the ability to infringe on this right where compelling state interests, unrelated to the suppression of ideas and not achievable through means significantly less restrictive of associational freedoms, are served.[236]

These two associational freedoms were the subject of a Supreme Court analysis concerning an organization's right to exclude women from its voting membership.[237] The Court found that the organization and its chapters were too large and unselective to find shelter under the doctrine of freedom of intimate association. While the Court conceded that the "[f]reedom of association therefore plainly presupposes a freedom not to associate," it concluded that the governmental interest in eradicating gender-based discrimination is superior to the associational rights of the organization's male members.[238] In general, the Court held that to tolerate this form of discrimination would be to deny "society the benefits of wide participation in political, economic, and cultural life."[239]

A state supreme court held that the state's antidiscrimination law was violated when a youth organization expelled a member, who was in a leadership position, because he was gay.[240] The court found that the organization was a "public accommodation" rather than a private organization, so the doctrine of freedom of association did not operate to protect the expulsion decision. The organization was held not to be private, in part, because it was "inclusive, not selective, in its membership practice."[241] The free speech doctrine argument failed before this court, in part, because the organization's members "do not associate for the purpose of disseminating the belief that homosexuality is immoral."[242]

Nonetheless, the Supreme Court, holding that the organization has a constitutional right, under the First Amendment, to exclude gay individuals from leadership positions because of their sexual orientation, overruled this decision.[243] Application of the state's antidiscrimination law was found to be a "severe intrusion" on the organization's rights to freedom of expressive association.[244] The Court's review of the record resulted in a finding that there was sufficient basis to conclude that the organization does "not want to promote homosexual conduct as a legitimate form of behavior."[245] The Court wrote: "The forced inclusion of an unwanted person in a

[234] Rent Control Coalition for Fair Housing v. Berkeley, 454 U.S. 290 (1981).
[235] NAACP v. Claiborne Hardware Co., 458 U.S. 886 (1982); Larson v. Valente, 456 U.S. 228 (1982); In re Primus, 436 U.S. 412 (1978); Abood v. Detroit Board of Education, 431 U.S. 209 (1977).
[236] Brown v. Socialist Workers '74 Campaign Committee, 459 U.S. 87 (1982); Democratic Party v. Wisconsin, 450 U.S. 107 (1981); Buckley v. Valeo, 424 U.S. 1 (1976); Cousins v. Wigoda, 419 U.S. 477 (1975); American Party v. White, 415 U.S. 767 (1974); NAACP v. Button, 371 U.S. 415 (1963); Shelton v. Tucker, 364 U.S. 486 (1960); NAACP v. Alabama, 347 U.S. 449 (1958).
[237] Roberts, Acting Comm'r, Minnesota Dep't of Human Rights v. United States Jaycees, 468 U.S. 609 (1984).
[238] *Id.* at 622–629.
[239] *Id.* at 625.
[240] Dale v. Boy Scouts of America, 734 A.2d 1196 (N.J. Sup. Ct. 1998).
[241] *Id.* at 1216.
[242] *Id.* at 1223.
[243] Boy Scouts of America v. Dale, 530 U.S. 640 (2000).
[244] *Id.* at 659.
[245] *Id.* at 651.

group infringes the group's freedom of expressive association if the presence of that person affects in a significant way the group's ability to advocate public or private viewpoints."[246]

The Court observed that organizations do not have to associate for the "purpose" of disseminating a certain message to be entitled to First Amendment protections.[247] Rather, an organization need merely engage in expressive activity that could be impaired to be entitled to free speech rights. The Court also noted that the First Amendment does not require that every member of a group agree on every issue in order for the group's policy to be expressive association. The dissenters wrote that this organization did not engage in the requisite level of expression on the subject to trigger this constitutional law protection.

§ 1.10 The Commerciality Doctrine

Occasionally, as part of the law of tax-exempt organizations, courts will create law or develop law that is in addition to statutory criteria.[248] This phenomenon is most obvious and extensive in connection with the evolution and application of the *commerciality doctrine*. These principles are impacting the law concerning qualification for exemption, so far only for charitable organizations,[249] and in the process helping shape the law of unrelated business activities.[250]

Despite its enormous effect to date, the commerciality doctrine is somewhat of an enigma. In writing the law of tax-exempt organizations over the decades, Congress did not create the doctrine. With one exception,[251] the word *commercial* does not appear in the federal statutory law concerning exempt organizations. Nor, with one exception,[252] is the term to be found in the applicable income tax regulations. It is, then, a doctrine created by courts.

Many court opinions comprise the essence of the commerciality doctrine.[253] In the single most important of the cases, the trial court concluded that the commerciality doctrine was the basis for denial of tax-exempt status, as a charitable and religious entity, to an organization associated with the Seventh Day Adventist Church that operated, in advancement of church tenets, vegetarian restaurants and health food stores.[254] The court wrote that the organization's "activity was conducted as a business and was in direct competition with other restaurants and health food stores."[255]

[246] *Id.* at 648.
[247] *Id.* at 655.
[248] See, e.g., § 1.8.
[249] See *Law of Tax-Exempt Organizations*, Chapters 7–11.
[250] *Id.*, Chapter 24.
[251] IRC § 501(m), which denies tax exemption to certain organizations that provide *commercial-type* insurance. See *Law of Tax-Exempt Organizations* § 27.13(b).
[252] The term *commercial* is used in the regulations as part of the elements for determining whether a business is regularly carried on. Thus, the regulations state that business activities of an exempt organization are ordinarily deemed to be regularly carried on if they "manifest a frequency and continuity, and are pursued in a manner, generally similar to comparable commercial activities of nonexempt organizations" (Reg. § 1.513-1(c)(1), (2)(ii)). See *Law of Tax-Exempt Organizations* § 24.3(a).
[253] They are collected at *Law of Tax-Exempt Organizations* § 4.10.
[254] Living Faith, Inc. v. Comm'r, 60 T.C.M. 710 (1990).
[255] *Id.* at 713.

This court added: "Competition with commercial firms is strong evidence of a substantial nonexempt purpose."[256]

When this case was considered on appeal, the appellate court affirmed the lower court decision.[257] The court of appeals opinion detailed the factors that the court relied on in finding commerciality and thus offered the best contemporaneous explication of the commerciality doctrine. These factors were that (1) the organization sold goods and services to the public,[258] (2) the organization was in "direct competition" with for-profit restaurants and food stores,[259] (3) the prices set by the organization were based on pricing formulas common in the retail food business (with the "profit-making price structure loom[ing] large" in the court's analysis and the court criticizing the organization for not having "below-cost pricing"[260]), (4) the organization utilized promotional materials and "commercial catch phrases" to enhance sales,[261] (5) the organization advertised its services and food, (6) the organization's hours of operation were basically the same as for-profit enterprises, (7) the guidelines by which the organization operated required that its management have "business ability" and six months training, (8) the organization did not utilize volunteers but paid salaries, and (9) the organization did not solicit or receive charitable contributions.

The commerciality doctrine is not the consequence of some grand pronouncement by the Supreme Court or, for that matter, any court. The doctrine simply evolved, growing from loose language in court opinions, which in turn seems to have reflected judges' personal views as to what the law ought to be (rather than what it is).[262] The commerciality doctrine appears to be the product of what is known in the law as *dictum*: a gratuitous remark written by a judge that need not have been authored to resolve the case. The term stems from the Latin "simplex dictum," meaning an assertion without proof, and later "obiter dictum," which means a statement lacking the force of an adjudication. The commerciality doctrine has, over the years, however, very much taken on the force of an adjudication.

The doctrine was initiated far before Congress enacted the unrelated business rules, which occurred in 1950. The element of commerciality was first mentioned, at least at the federal law level, in 1924, by the Supreme Court.[263] The case concerned a tax-exempt religious order that was operated for religious purposes but that engaged in other activities that the government alleged destroyed the basis for its exemption; the order had extensive investments in real estate and stock holdings that returned a profit, as well as some incidental sales of wine, chocolate, and other items. The Court held that the order was exempt as a religious entity, justifying its investment and business efforts by writing that "[s]uch [religious] activities cannot be carried on without money."[264]

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[256] *Id.*

[257] Living Faith, Inc. v. Comm'r, 950 F.2d 365 (7th Cir. 1991).

[258] This factor alone was said to make the operations "presumptively commercial" (*id.* at 373).

[259] *Id.*

[260] *Id.*

[261] *Id.*

[262] How else explain the notion that a nonprofit organization is to be considered *commercial* in nature if its hours of operation are similar to those of for-profit ones or if it has employees? Or, an entity is *commercial* if it charges fees? If that were the law, what would happen to the tax exemption for schools, colleges, universities, hospitals, museums, theaters, symphony orchestras, and opera houses?

[263] Trinidad v. Sagrada Orden de Predicadores de la Provincia del Santisimo Rosario de Filipinas, 263 U.S. 578 (1924).

[264] *Id.* at 581.

In this case, the Court did not articulate a commerciality doctrine. It characterized the government's argument as being that the order is "operated also for business and *commercial* purposes."[265] The Court rejected this portrayal of the order's activities, writing that there was no "competition" and that while the "transactions yield some profit [it] is in the circumstances a negligible factor."[266] Thus, in this case, the Court did not enunciate the commerciality doctrine; however, by using the word in describing the government's position, the commerciality doctrine was born.

The rules that flowed out of this Supreme Court opinion are reflected today in the *operational test*, which is stated in the tax regulations.[267] The opinion laid down the rule that a charitable organization can engage in business activities for profit, without loss of tax exemption, if its net income is destined for charitable uses. This rule, the *destination-of-income test*, was terminated by Congress in 1950, when it enacted the law of *feeder organizations*.[268]

Repeal of the destination-of-income test, however, did not extinguish what has been termed the *activities standard*.[269] This standard is used where a nonprofit organization engages in activities that, while commercial, further exempt purposes.[270] Today, the activities standard survives as the operational test.

This Supreme Court decision in 1924 established another point: Where a tax-exempt organization's nonexempt activities are a negligible factor (as was the sale by the religious order of wine and chocolate), they are considered *incidental* in relation to exempt purposes and thus have no adverse effect on the exemption.[271] This aspect of the law is today reflected in the statutory rule that an exempt charitable organization must be operated *exclusively* for exempt purposes, with today's understanding that the word *exclusively* is a term of art that means *primarily*.[272]

§ 1.11 Constitutionality of Lobbying Limitation

The federal tax law bars tax-exempt charitable organizations from engaging in legislative and propagandizing activities to a substantial extent.[273] It has been repeatedly asserted that this proscription on activities violates constitutional law principles. Although the issues were often presented to courts, it was not until 1982 that a litigant was successful in securing a decision finding that this provision is constitutionally deficient. Nonetheless, even that remarkable occurrence ultimately failed—almost with unintended consequences for other categories of tax-exempt organizations.

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[265] *Id.* (emphasis added).
[266] *Id.* at 582.
[267] Reg. § 1.501(c)(3)–1(c)(1). See *Law of Tax-Exempt Organizations* § 4.5.
[268] IRC § 502. An analysis of the cases applying the destination-of-income test and of its transition out of existence is in Lichter Found. v. Welch, 247 F.2d 431 (6th Cir. 1957). See *Law of Tax-Exempt Organizations* § 27.13.
[269] Fides Publishers Ass'n v. United States, 263 F. Supp. 924 (N.D. Ind. 1967).
[270] *Id.* at 933–934.
[271] Trinidad v. Sagrada Orden de Predicadores de la Provincia del Santisimo Rosario de Filipinas, 263 U.S. 578, 582 (1924).
[272] See § 1.6.
[273] IRC § 501(c)(3) (limitation enacted in 1934). This prohibition is also applicable to exempt health insurance issuers (IRC § 501(c)(29)(B)(iii)) (enacted in 2010).

Representative of one of these decisions was one handed down in 1979.[274] The issues involved were the following: Does this tax law limitation on legislative activities (1) impose an unconstitutional condition on the exercise of First Amendment rights (that is, the rights to engage in these advocacy activities), (2) restrict the exercise of First Amendment rights as being a discriminatory denial of tax exemption for engaging in speech, (3) deny organizations so restricted the equal protection of the laws in violation of the Fifth Amendment, and/or (4) lack a compelling governmental interest that would justify the restrictions on First Amendment rights?

The approach of the courts on the First Amendment question has been to recognize that the lobbying of legislators constitutes an exercise of the First Amendment right of petition[275] and thus that the amendment protects the legislative activities. Often cited in this context is the Supreme Court's declaration that the general advocacy of ideas is constitutionally protected as part of the nation's "profound national commitment to the principle that debate on public issues should be uninhibited, robust, and wide-open."[276] Courts inevitably press on to observe, however, that the federal tax law limitation on charities' lobbying efforts does not violate First Amendment rights because it does not on its face prohibit these organizations from engaging in substantial activities to influence legislation.[277]

This position is fundamentally based on a Supreme Court pronouncement upholding the constitutionality of a tax regulation that excluded from deduction, as business expenses, amounts expended for the promotion or defeat of legislation.[278] On that occasion, the Court stated that the taxpayers were "not being denied a tax deduction because they engage in constitutionally protected activities, but are simply being required to pay for these activities entirely out of their own pocketbook, as everyone else engaging in similar activities is required to do under the provisions of the Internal Revenue Code."[279] That is, if they wish to engage in substantial legislative activities, charitable organizations are required to fund these efforts from their own (after-tax) resources, and the resulting loss of tax-exempt status is not regarded as an impermissible result for engaging in constitutionally protected activities.

With respect to the second aspect of the First Amendment question, this argument is premised in part on the fact that several categories of tax-exempt organizations are free to lobby without jeopardizing their exempt status.[280] Thus, the proposition has been that the restraint on lobbying by charitable organizations is a discriminatory revocation or denial of a tax exemption for engaging in protected speech. Courts hold that this principle relates to legislative efforts "aimed at the suppression of dangerous ideas"[281] and not to denials or revocations of tax exemptions for charitable organizations.

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[274] Taxation With Representation of Washington v. Blumenthal, 79-1 U.S.T.C.¶ 9185 (D.D.C. 1979), *aff'd*, 81-1 U.S.T.C. ¶ 9329 (D.C. Cir. 1981), *rev. en banc sub nom*., Taxation With Representation of Washington v. Regan, 676 F.2d 715 (D.C. Cir. 1982).

[275] E.g., Eastern R.R. Presidents Conference v. Noerr Motor Freight, Inc., 365 U.S. 127 (1961); Liberty Lobby, Inc. v. Pearson, 390 F.2d 489 (D.C. Cir. 1968).

[276] New York Times Co. v. Sullivan, 376 U.S. 254, 270 (1964). See Chapter 5.

[277] Taxation With Representation v. United States, 585 F.2d 1219 (4th Cir. 1978), *cert. den*., 441 U.S. 905 (1979).

[278] Cammarano v. United States, 358 U.S. 498 (1959).

[279] *Id*. at 513.

[280] See *Law of Tax-Exempt Organizations* §§ 22.5–22.7.

[281] Speiser v. Randall, 357 U.S. 513, 519 (1958), where the Court struck down a state statute that required veterans to take a loyalty oath as a condition for the receipt of a veterans' property tax exemption.

Similar short shrift has been given to the equal protection challenge, which is premised on the fact that similarly situated (that is, tax-exempt) organizations are accorded different treatment with respect to lobbying activities. The courts usually concede that this involves a classification that imposes differing treatment to classes but that it is permissible inasmuch as the classification does not affect a "fundamental" right nor involve a "suspect class."[282] The applicable standard of scrutiny—which this statutory limitation has been repeatedly ruled to satisfy—is whether the challenged classification is reasonably related to a legitimate governmental purpose.[283]

This standard is also deemed met where the courts evaluate the constitutionality of the proscription on substantial legislative activities in relation to the requirement that the restraint be rationally related to a legitimate governmental purpose.[284] Several of these purposes are usually found served: "assurance of governmental neutrality with respect to the lobbying activities of charitable organizations; prevention of abuse of charitable lobbying by private interests; and preservation of a balance between the lobbying activities of charitable organizations and those of non-charitable organizations and individuals."[285]

Thus, until 1982, all courts that considered the matter had made it clear that there is no constitutional imperfection in the federal tax anti-lobbying clause applicable to tax-exempt charitable organizations.[286] In that year, however, a federal court of appeals temporarily changed the complexion of the constitutional law concerning the anti-lobbying rule applicable to charitable entities. This appellate court agreed that this restriction on legislative activities does not violate free speech rights but—after concluding that an organization that acquires recognition of tax exemption and charitable donee status is thereby receiving a governmental subsidy[287]—held that this subsidy cannot constitutionally be accorded on a discriminatory basis and that to do so violates equal protection rights.[288] Therefore, the court held, the fact that exempt charitable organizations are required to limit their lobbying to an insubstantial extent, while certain other exempt organizations—such as veterans' organizations—can lobby without these limits, is an unconstitutionally discriminatory allocation of this "government subsidy."[289]

This appellate court held that "[b]y subsidizing the lobbying activities of veterans' organizations while failing to subsidize the lobbying of . . . charitable groups,

[282] E.g., San Antonio Independent School District v. Rodriguez, 411 U.S. 1 (1973); Dunn v. Blumstein, 405 U.S. 330 (1972); Shapiro v. Thompson, 394 U.S. 618 (1969).

[283] E.g., United States Dep't of Agriculture v. Moreno, 413 U.S. 528 (1973); Frontiero v. Richardson, 411 U.S. 677 (1973).

[284] E.g., United States v. O'Brien, 391 U.S. 367 (1968); Schenk v. United States, 249 U.S. 47 (1919).

[285] Taxation With Representation of Washington v. Blumenthal, 79-1 U.S.T.C. ¶ 9185 (D.D.C. 1979), *aff'd*, 81-1 U.S.T.C. ¶ 9329 (D.C. Cir. 1981), *rev. en banc sub nom.*, Taxation With Representation of Washington v. Regan, 676 F.2d 715 (D.C. Cir. 1982).

[286] Haswell v. United States, 500 F.2d 1133, 1147–1150 (Ct. Cl. 1974), *cert. den.*, 419 U.S. 1107 (1974); Tax Analysts & Advocates v. Shultz, 74-2 U.S.T.C. ¶ 9601 (D.D.C. 1974), *aff'd*, 512 F.2d 992 (D.C. Cir. 1975) (where a lawsuit to declare the legislative activities provision of IRC § 501 (c)(3) unconstitutional was dismissed).

[287] See § 1.12.

[288] Taxation With Representation of Washington v. Regan, 676 F.2d 715 (D.C. Cir. 1982).

[289] Charitable organizations are those that are tax-exempt by reason of IRC § 501(c)(3) and that are charitable donees by reason of IRC § 170(c)(2); veterans' organizations are exempt by reason of IRC § 501(c)(3), (4), or (19) and are charitable donees by reason of IRC § 170(c)(3). See *Law of Tax-Exempt Organizations*, Chaps. 7 and 13, § 19.11(a).

Congress has violated the equal protection guarantees of the Constitution."[290] While the court decided that the challenge to the lobbying restriction is "weak," if based solely on free speech claims, and is "weak" if based solely on equal protection claims,[291] it concluded that the "whole of . . . [the] argument well exceeds the sum of its parts" and that a "First Amendment concern must inform the equal protection analysis in this case."[292]

As a prelude to its findings, the court concluded that a "high level of scrutiny is required" because the lobbying restriction imposed on charitable organizations "constitutes a limitation on protected First Amendment activity" and because the equal protection argument involves "what is clearly a fundamental right."[293] Under law, this "scrutiny" requires a determination as to whether a "substantial governmental interest supports the classification."[294] The court based its conclusion on the premise that nonprofit organizations that embody the features of both tax exemption and eligibility to attract tax-deductible contributions are essentially alike. Inasmuch as the court was not persuaded that there is a valid governmental interest to be served by treating charitable entities and veterans' entities differently on the matter of lobbying, the court ruled that the distinctions between the two classes of exempt organizations are "post hoc rationales" that are "constitutionally illegitimate."[295] Hence, the court found an unconstitutional denial of equal protection rights.

The remedy desired by the organization that initiated this case was invalidation of the lobbying restriction on charitable organizations. This the court was disinclined to do. First, it wrote that unfettered lobbying by charitable organizations would increase the likelihood of "selfish" contributions made solely to advance the donors' personal legislative interests.[296] Second, the court concluded that Congress believes that the public interest requires limitations on lobbying by charitable organizations and that "[e]ven when they attempt to remedy constitutional violations, courts must resist ordering relief that clearly exceeds the legitimate expectations of Congress."[297] The reverse approach—to place the same restrictions on veterans' groups as are imposed on charitable organizations—was far more appealing to the court and received serious consideration, but the court hesitated to strike down what it termed the "preferential treatment now accorded the lobbying of veterans' organizations," since veterans' groups were not parties to the litigation.[298] Instead, the case was ordered remanded to the district court "with the instruction that it cure the constitutionally invalid operation of Section 501(c) after inviting veterans' organizations to participate in framing the relief."[299] Before that remand could occur, however, the decision was appealed to the Supreme Court.

The Supreme Court reacted swiftly, in 1983, unanimously reversing the court of appeals.[300] In so holding, the Court reiterated its position that the lobbying restriction

[290] Taxation With Representation of Washington v. Regan, 676 F.2d 715, 717 (D.C. Cir. 1982).
[291] *Id.* As to the equal protection aspect, the court observed that Congress has "vast leeway under the Constitution to classify the recipients of its benefits and to favor some groups over others" (*id.* at 740).
[292] *Id.* at 715.
[293] *Id.* at 730.
[294] *Id.* at 731.
[295] *Id.* at 739.
[296] *Id.* at 742.
[297] *Id.*
[298] *Id.* at 743.
[299] *Id.* at 744.
[300] Regan v. Taxation With Representation of Washington, 461 U.S. 540 (1983).

on charitable organizations does not infringe First Amendment rights or regulate any First Amendment activity, that Congress did not violate the equal protection doctrine in the Fifth Amendment, and that Congress acted rationally in subsidizing (by means of tax exemption and charitable deductions) lobbying by veterans' organizations while not subsidizing lobbying by charitable organizations.

As to the free speech issue, the Court held that the federal tax law "does not deny . . . [a charitable organization] the right to receive deductible contributions to support its non-lobbying activity, nor does it deny . . . [a charitable organization] any independent benefit on account of its intention to lobby" but that Congress "has merely refused to pay for the lobbying out of public moneys."[301]

Noting that "[l]egislatures have especially broad latitude in creating classifications and distinctions in tax statutes," the Court concluded that the distinctions in the lobbying context made by Congress between charitable and veterans' organizations do not employ any "suspect classification," do not violate equal protection principles, and are "within Congress' broad power in this area."[302] Moreover, the Court accepted the view that Congress "was concerned that exempt [charitable] organizations might use tax-deductible contributions to lobby to promote the private interests of their members" and that "[o]ur country has a long standing policy of compensating veterans for their past contributions by providing them with numerous advantages."[303] Consequently, it appears that the proscription on substantial legislative activities by charitable organizations contained in the federal tax rules is beyond further constitutional law challenge in the courts.[304]

Constitutional law challenges in the lobbying context involving tax-exempt organizations have not been confined to the realm of charitable organizations, although the success rate of these other challenges is no better than those initiated by charities. The business league/association community challenged the constitutionality of the rules by which the deductibility, as a business expense, of the dues paid by members of an association is limited as a consequence of lobbying (or political campaign activity) by the association.[305] This challenge—on free speech and equal protection grounds—failed, and did so for the same basic reasons that the challenges in the charitable setting failed: Congress has broad latitude in creating classifications and distinctions in tax statutes[306] and Congress did not preclude associations from lobbying, but instead lawfully eliminated a tax subsidy underlying the lobbying activity.[307] As the lower court stated in its conclusion, the "challenged provisions do not impose 'penalties' on tax-exempt associations that engage in lobbying, but merely enforce the

[301] *Id.* at 545. This thus was a restatement of the Court's position in Cammarano v. United States, 358 U.S. 498 (1959).

[302] Regan v. Taxation With Representation of Washington, 461 U.S. 540, 547–550 (1983).

[303] *Id.* at 550–551.

[304] A concurring opinion took the position that the lobbying restriction in IRC § 501(c)(3) is, viewed in isolation, unconstitutional but that the defect is cured by the presence of IRC § 501(c)(4). This stance rests on the premise that an IRC § 501(c)(3) organization may utilize an IRC § 501(c)(4) affiliate for lobbying purposes and that contemporary administrative policy is to allow this in-tandem relationship to function relatively unfettered. See *Law of Tax-Exempt Organizations* § 28.3. This concurring opinion further stated that "[a]ny significant restriction on this channel of communication would, however, negate the saving effect of [IRC] § 501(c)(4)" (*id.* at 553).

[305] See *Law of Tax-Exempt Organizations* § 22.6(a).

[306] See text accompanied by *supra* note 302.

[307] See text accompanied by *supra* note 301.

decision of Congress to eliminate the lobbying subsidy."[308] The speech about legislation was found to encompass the "entire spectrum of possible viewpoints and is, therefore, content neutral"[309]—a finding that blunted the claim that the challenged provisions discriminate on the basis of the content of the speech. These tax law provisions were held to be rationally related to a legitimate government interest and thus constitutional, in relation to both free speech and equal protection principles.[310]

§ 1.12 Tax Exemption as Government Subsidy

The Supreme Court has been dramatically inconsistent, as reflected in its five principal opinions on the point, when determining if a tax exemption accorded a class of nonprofit organizations is a *subsidy*, provided by the government that legislated the exemption, although concurring and dissenting opinions have been amply clear (albeit severely diametric). These contradictions have never been fully reconciled (let alone explained) by the Court, leaving this matter of tax exemption for nonprofit organizations as a subsidy, or some other type of government-provided economic benefit, an ongoing controversy.[311]

"A tax exemption is a subsidy," declared a justice in a dissent in the first of these cases, claiming an exemption to be no different than a government grant.[312] The issue, of course, is the accuracy of that statement. On the face of it, the proposition seems rather obvious: Tax exemptions are indisputably forms of economic benefits provided by governments (federal, state, and local) to eligible nonprofit organizations and charitable deductions are economic benefits provided by governments to charitable organizations.[313] This approach has been (fairly or unfairly) fueled by the concept of tax expenditures.[314] Yet, on reflection, this matter of whether exemptions and charitable deductions are something more than economic benefits proves to be not clear at all.

[308] American Soc'y of Ass'n Executives v. United States, 23 F. Supp. 2d 64, 69 (D.D.C. 1998).
[309] *Id.* at 70. This decision was affirmed (195 F.3d 47 (D.C. Cir. 1999)); the Supreme Court declined to review it (529 U.S. 1108 (2000)).
[310] Also American Soc'y of Ass'n Executives v. Bentsen, 848 F. Supp. 245 (D.D.C. 1994).
[311] For example, the Court majority in Arizona Christian School Tuition Organization v. Winn, 131 S. Ct. 1436 (2011) wrote that the premise that tax credits are to be equated with direct government expenditures "finds no basis in standing jurisprudence" (at 1448). The dissent wrote that "[t]his novel distinction in standing law between appropriations and tax expenditures has as little basis in principle as it has in our precedent" (at 1450). Neither side cited any authority. See § 1.12(e). This silence is not confined to the law surrounding standing.
[312] Walz v. Tax Comm'n of City of New York, 397 U.S. 664, 704 (1970).
[313] The Court majority in Arizona Christian School Tuition Organization v. Winn, 131 S. Ct. 1436 (2011), wrote: "It is easy to see that tax credits and governmental expenditures can have similar economic consequences, at least for beneficiaries whose tax liability is sufficiently large to take full advantage of the credit" (at 1447). A federal district court observed (in finding that tax exemptions and charitable deductions are no more than indirect governmental subsidies): "Though to be sure the possession of such an exemption obviously makes the possessor the 'recipient' of a higher net income than if it had to pay taxes, and presumably the beneficiary of more receipts because of the deductibility of its donors' contributions, those benefits . . . must be recognized as indirect rather than direct subsidies" (Johnny's Icehouse, Inc. v. Amateur Hockey Ass'n of Illinois, 134 F. Supp. 2d 965, 972 (N.D. Ill. 2001)).
[314] See § 1.12(g).

One of the reasons this topic is important is the proverbial slippery slope effect. Advocates of the notion that tax exemptions for nonprofit organizations are to be viewed as government appropriations push their argument within the following framework of logic: If a tax exemption is an economic benefit (direct or indirect), then it amounts to government sponsorship; if it is government sponsorship, then it must be a subsidy; if it is a subsidy, then it must be identical to an appropriation; if it is the same as an appropriation, then it must be a form of governmentally provided financial assistance. Part of the difficulty in this regard stems from the fact that the Court has never adequately addressed the true import of nonprofit organizations in U.S. society or, perhaps more narrowly, the meaning of tax exemptions for nonprofit organizations in U.S. law.[315]

Here are some basic elements of political philosophy that the Court has never written about. It is a fundamental precept of political philosophy that a healthy democratic state—or, as some prefer, a civil society—requires three vibrant sectors: a governmental sector, a commercial (for-profit, business) sector, and a nonprofit sector. This vibrancy includes ongoing tension among the sectors as to which activities properly belong in which sector. This tripartite arrangement leads to pluralism of society—a unique American trait.[316]

The most the Court has provided in recognition of the foregoing elements of political philosophy is the observation in a concurring opinion that "government grants exemptions to religious organizations because they uniquely contribute to the pluralism of American society by their religious activities," adding that government may "properly include religious institutions among the variety of private, nonprofit groups that receive tax exemption, for each group contributes to the diversity of association, viewpoint, and enterprise essential to a vigorous, pluralistic society."[317]

Of the three, the governmental sector has the most expansionist tendencies (engaging in, in the words of a federal district court, "tactic[s] to achieve enlarged regulatory license"[318]). Society is best served when these tensions are in relative balance. In countries where a nonprofit sector is repressed (e.g., Russia, China), democratic principles suffer.

For over 100 years, the United States has operated in accordance with the basic principle that a healthy nonprofit sector is dependent on the law elements of tax exemptions and the charitable contribution deductions. Since the inception of the federal income tax, the view of most lawmakers and other policymakers has generally been that non-taxation of the nonprofit sector is in accordance with this political philosophy, as manifested in many forms over the centuries.

As noted, very little of the foregoing political philosophy is reflected in Supreme Court opinions. The Court hesitatingly (and in a footnote) wrote: "Evidently the exemption is made in recognition of the benefit which the public derives from

[315] See § 1.7.

[316] A hint of recognition by the Court of this philosophy is found in the case involving the constitutionality of a state tax credit for gifts to scholarship-granting organizations, where the majority rejected the notion that "income should be treated as if it were government property even if it has not come into the tax collector's hands" (Arizona Christian School Tuition Organization v. Winn, 131 S. Ct. 1436, 1448 (2011)).

[317] Walz v. Tax Comm'n of City of New York, 397 U.S. 664, 689 (1970). Actually, the federal government does not *grant* tax exemptions; it grants *recognition of* tax exemptions (see *Law of Tax-Exempt Organizations* § 3.2). The exemptions are already in being (if they exist) by operation of law. This is another illustration of the fact that the Supreme Court has never articulated some of the refinements of the law of tax-exempt organizations.

[318] Virginia v. Sebelius, 728 F. Supp. 2d 768, 786 (E.D. Va. 2010).

corporate activities of the class named, and is intended to aid them when not conducted for private gain."[319] The Court has made reference to "nonprofit, quasi-public corporations which include hospitals, libraries, playgrounds, scientific, professional, historical, and patriotic groups," and observed that the "State has an affirmative policy that considers these groups as beneficial and stabilizing influences in community life and finds this classification useful, desirable, and in the public interest."[320] In a concurring opinion, a justice wrote that religious organizations are exempt from tax "because they, among a range of other private, nonprofit organizations contribute to the well-being of the community in a variety of nonreligious ways, and thereby bear burdens that would otherwise either have to be met by general taxation, or be left undone, to the detriment of the community."[321]

The Court also observed that tax exemptions for and deductibility of gifts to charitable organizations were enacted to provide tax benefits to these entities to "encourage the development of private institutions that serve a useful public purpose or supplement or take the place of public institutions of the same kind."[322] It added: "Tax exemptions for certain institutions thought beneficial to the social order of the country as a whole, or to a particular community, are deeply rooted in our history."[323] And: "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."[324]

There are those, of course, who advocate trimming or abolishment of tax exemptions and charitable deductions. These, not surprisingly, tend to be champions of larger government. They distrust the voices of the populace and want centralized decision-making at the federal government level. Usually, these anti-nonprofit sector voices fade; they are rarely taken too seriously for very long.

The biggest hit the charitable deductions have taken over recent years came with the advent of, then the redefining of, tax expenditures.[325] (Tax exemptions for nonprofit organizations generally are not considered tax expenditures.) In the most benign of interpretations, tax expenditures give policymakers a view of the economic impact of tax law preferences. But, too many see these expenditures as a "cost" to the federal treasury; simple repeal of one or more of them will, this line of thinking goes, bring billions of dollars into the U.S. Treasury. The calls for repeal of tax expenditures—inevitably tagged as forms of "backdoor spending"—become more frequent and louder as the national government's debt load increases.[326]

In any event, not all tax expenditures are created equally. Charitable deductions are key to a strong nonprofit sector, which in turn is essential to a democratic society.

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[319] Trinidad v. Sagrada Orden de Predicadores de la Provincia del Santisimo Rosario de Filipinas, 263 U.S. 578, 581, n. 15 (1924).

[320] Walz v. Tax Comm'n of City of New York, 397 U.S. 664, 673 (1970).

[321] *Id.* at 687.

[322] Bob Jones Univ. v. United States, 461 U.S. 574, 588 (1983).

[323] *Id.*

[324] *Id.* at 591.

[325] See § 1.12(g).

[326] For example, the National Commission on Fiscal Responsibility and Reform, created by executive order, issued a report (not formally adopted by the Commission) on December 1, 2010, titled the "Moment of Truth." Its focus was on deficit reduction and simplification of the tax law. These goals would be partially achieved by repealing all tax expenditures (said by the commission to achieve $4 trillion in revenue and expense reduction), including the federal tax law charitable deductions.

No one really knows what repeal of the charitable deductions would do to the charitable sector. (Studies show that a shift to a tax credit approach would dramatically alter the directions in which charitable dollars would flow.) It appears likely that charitable giving would decline. It also seems probable that the federal government's coffers would not be ballooned by the $242.6 billion suggested by the concept of tax expenditures.[327] (Over recent years, the federal income tax charitable deduction was the sixth or seventh largest tax expenditure; currently, it is the fifth.)

In the first of the five principal Supreme Court opinions concerning this matter, the majority opinion held that a tax exemption, although an *indirect economic benefit*, is not a form of governmental *sponsorship*; two concurring opinions held that an exemption is not a *subsidy*, while the dissent asserted that it is.[328] In the second of these cases, the Court stated that tax exemptions and charitable deductions are a *form of subsidy*.[329] In the third of these cases, the Court repeatedly made reference to tax exemptions and tax deductions for charitable gifts as *tax benefits*.[330] In the fourth, a bare majority of the Court stated that tax exemptions are not financial subsidies; two dissents proclaimed that exemptions are subsidies.[331] In the fifth, another bare majority held that plaintiffs lacked Establishment Clause standing where their cause was premised on the thought that tax credits are government expenditures; the dissent asserted that the credits are government expenditures because they accomplish the same government objective.[332]

(a) Religious Organizations Real Estate Tax Exemption Case

In the case concerning the constitutionality of a state's real estate tax exemption that includes exemption for the holdings of religious organizations, the Court observed that "[g]ranting tax exemptions . . . necessarily operates to afford an indirect economic benefit" on the exempted entities,[333] yet the "grant of a tax exemption is not sponsorship [of the exempted organization by the government] since the government does not transfer part of its revenue to [the exempt entity] but simply abstains from demanding that [it] support the state."[334] It was added that "[n]o one has ever suggested that tax exemption has converted libraries, art galleries, or hospitals into arms of the state or put employees 'on the public payroll.'"[335] Thus, the Court majority in this case did not explicitly address the point as to whether tax exemption is a subsidy; it is, said the Court, an "indirect economic benefit" but it is not a form of government "sponsorship."[336]

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[327] Among the flaws inherent in the concept of federal tax expenditures is the supposition that individuals' behavior would remain constant if a tax expenditure were to be repealed. This, however, is unlikely. For example, if the federal income tax charitable contribution were to be repealed, surely there would be a considerable decline in charitable giving, causing a corresponding decline in the alleged worth of this tax expenditure to the government.

[328] See § 1.12(a).

[329] See § 1.12(b).

[330] See § 1.12(c).

[331] See § 1.12(d).

[332] See § 1.12(e).

[333] Walz v. Tax Comm'n of City of New York, 397 U.S. 664, 674 (1970).

[334] *Id.* at 675.

[335] *Id.*

[336] *Id.* at 674, 675. This matter of tax exemption as a subsidy was considered in this case in the context of the extent of the entanglement of church and state. The Court wrote that tax exemption "creates only a minimal and remote involvement between church and state and far less

A concurring opinion, however, took this issue on rather bluntly. There it was written that "those who urge the exemptions' unconstitutionality [when accorded to religious entities] argue that exemptions are the equivalent of governmental subsidy of churches."[337] This opinion then proceeded to answer the question, by stating that tax exemptions are not government-provided subsidies:

> *Tax exemptions and general subsidies, however, are qualitatively different. Though both provide economic assistance, they do so in fundamentally different ways. A subsidy involves the direct transfer of public monies to the subsidized enterprise and uses resources exacted from taxpayers as a whole. An exemption, on the other hand, involves no such transfer. It assists the exempted enterprise only passively, by relieving a privately funded venture of the burden of paying taxes. In other words, in the case of a direct subsidy, the state forcibly diverts the income of both believers and nonbelievers to churches, while in the case of an exemption, the state merely refrains from diverting to its own uses income independently generated by the churches through voluntary contributions. Thus, the symbolism of tax exemption is significant as a manifestation [of the principle] that organized religion is not expected to support the state; by the same token the state is not expected to support the church. Tax exemptions, accordingly, constitute mere passive state involvement with religion and not the affirmative involvement characteristic of outright governmental subsidy.*[338]

This concurring opinion also stated: "To the extent that purely religious activities are benefited by the exemptions, the benefit is passive. Government does not affirmatively foster these activities by exempting religious organizations from taxes, as it would were it to subsidize them. The exemption simply leaves untouched that which adherents of the organization bring into being and maintain."[339]

Another concurring opinion also arrived at the heart of the matter. It cannot be denied that a tax exemption, albeit passive (and thus not a subsidy), provides a financial benefit to the exempted entity; that is why the Court majority in this case referred to a tax exemption as an "indirect economic benefit."[340] Accordingly, it was written in this concurring opinion that "exemptions do not differ from subsidies *as an economic matter*."[341] And: "Aside from the longstanding tradition behind exemptions there are other differences, however. Subsidies, unlike exemptions, must be passed on periodically and thus invite more political controversy than exemptions. Moreover, subsidies or direct aid, as a general rule, are granted on the basis of enumerated and more complicated qualifications and frequently involve the state in administration to a higher degree, though to be sure, this is not necessarily the case."[342]

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than taxation of churches," and that exemption "restricts the fiscal relationship between church and state, and tends to complement and reinforce the desired separation insulating each from the other" (*id.* at 676). It also wrote that the "legislative purpose of the property tax exemption is neither the advancement nor the inhibition of religion; it is neither *sponsorship* nor hostility" (*id.* at 672) (emphasis added).

[337] *Id.* at 690. It was added: "General subsidies of religious activities would, of course, constitute impermissible state involvement with religion" (*id.*). See § 2.6(b).

[338] *Id.* at 690–691 (internal quotations, footnotes, and other references omitted).

[339] *Id.* at 693.

[340] *Id.* at 674.

[341] *Id.* at 699 (emphasis added).

[342] *Id.*

A dissenting justice was nonetheless adamant that a tax exemption is a governmentally provided subsidy. Thus, he wrote that "I would suppose that in common understanding one of the best ways to 'establish' one or more religions is to subsidize them, which a tax exemption does."[343] Later in this dissent, he observed: "The financial support rendered here is to the church, the place of worship. A tax exemption is a subsidy. Is my Brother [justice] correct in saying that we would hold that state or federal grants to churches, say, to construct the edifice itself would be unconstitutional? What is the difference between that kind of subsidy and the present subsidy?"[344]

This dissenter revealed his true concerns in this regard near the close of his dissent. Clearly, he was more concerned about what the majority decision might *lead to*, rather than what it meant confined to the facts of the case: "The exemptions provided here insofar as welfare projects are concerned may have the ring of neutrality. But subsidies either through direct grant or tax exemption for sectarian causes, whether carried on by church *qua* church or by church *qua* welfare agency, must be treated differently, lest we in time allow the church *qua* church to be on the public payroll, which, I fear, is imminent."[345]

(b) Limitation on Lobbying Case

In a case challenging the constitutionality of the restriction on lobbying by tax-exempt charitable organizations,[346] the Court wrote: "Both tax exemptions and tax deductibility are a form of subsidy that is administered through the tax system. A tax exemption has much the same effect as a cash grant to the organization of the amount of tax it would have to pay on its income [were it taxable]. Deductible contributions are similar to cash grants of the amount of a portion of the individual's contribution. The system Congress has enacted provides this kind of subsidy to nonprofit civic welfare organizations generally, and an additional subsidy to those charitable organizations that do not engage in substantial lobbying."[347] Having so declared, the Court added that "[i]n stating that exemptions and deductions, on the one hand, are like cash subsidies, on the other, we of course do not mean to assert that they are in all respects identical."[348]

(c) Racially Discriminatory School Case

The Court, in the course of holding that tax exemption is not available for nonprofit private schools that prescribe and enforce racially discriminatory admissions standards because this type of exemption is contrary to federal public policy,[349] observed that Congress, in enacting tax exemption for charitable organizations and deductibility of charitable contributions, "sought to provide tax benefits to [these] organizations, to encourage the development of private institutions that serve a useful public purpose or

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[343] *Id.* at 701.
[344] *Id.* at 704.
[345] *Id.* at 711.
[346] See § 1.11.
[347] Regan v. Taxation With Representation of Washington, 461 U.S. 540, 544 (1983) (footnote omitted).
[348] *Id.*, note 5, citing the majority opinion and the two concurring opinions in *Walz* (see § 1.12(a)).
[349] See § 1.8.

supplement or take the place of public institutions of the same kind."[350] It reiterated the point when it added that "Congress deemed the specified organizations entitled to tax benefits because they served desirable public purposes."[351] Also: "Denial of tax benefits will inevitably have a substantial impact on the operation of private religious schools, but will not prevent those schools from observing their religious tenets."[352]

(d) Commerce Clause Case

The Court, in holding that a discriminatory real estate tax exemption violated the dormant Commerce Clause,[353] extended its view that tax exemptions are not, as a matter of constitutional law, governmentally provided financial subsidies.[354] Two dissents, however, asserted that exemptions are subsidies.[355]

The focus of this opinion is on analysis of the legal principle that nonprofit organizations may engage in interstate commerce and thus that the Commerce Clause jurisprudence applies in the nonprofit entity context. Having declared that, "[f]or purposes of Commerce Clause analysis, any categorical distinction between the activities of profit-making enterprises and not-for-profit entities is . . . wholly illusory,"[356] the Court proceeded to reexamine this matter of tax exemption as a subsidy.

In the case, the appellee's argument was that the state's tax exemption "should be viewed as an expenditure of government money designed to lessen its social service burden and to foster the societal benefits provided by charitable organizations," thus setting up the argument that this "tax exemption scheme" is a "legitimate discriminatory subsidy of only those charities that choose to focus their activities on local concerns."[357] This argument was found unpersuasive to the Court majority, which observed that, "[a]lthough tax exemptions and subsidies serve similar ends, they differ in important and relevant respects, and our cases have recognized these distinctions."[358]

The Court recalled its decision in the case concerning a state's real estate tax exemption that applied to property of a church, where it held that the exemption did not violate the First Amendment's Establishment Clause.[359] It wrote that this holding "rested, in part, on the premise that there is a constitutionally significant difference between subsidies and tax exemptions."[360] It added: "We have expressly recognized that this distinction is also applicable to claims that certain state action designed to

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[350] Bob Jones Univ. v. United States, 461 U.S. 574, 588 (1983).
[351] *Id.* at 589.
[352] *Id.* at 603–604.
[353] See Chapter 3.
[354] Camps Newfound/Owatonna, Inc. v. Town of Harrison, 520 U.S. 564 (1997).
[355] See § 3.5.
[356] Camps Newfound/Owatonna, Inc. v. Town of Harrison, 520 U.S. 564, 586 (1997).
[357] *Id.* at 588–589. An alternative argument (albeit a rejected one) advanced as a product of this "tax exemption scheme" was that the exemption amounts to a governmental "purchase" of charitable services falling within a narrow exception to the dormant Commerce Clause for states in their role as "market participants" (*id.*).
[358] *Id.* at 589. The Court also noted that it "recognized long ago that a tax exemption can be viewed as a form of government spending," citing Regan v. Taxation With Representation of Washington, 461 U.S. 540, 544 (1983). But, in *Regan*, the Court did not refer to "a form of government spending" but held that tax exemptions and charitable deductions are "a form of subsidy that is administered through the tax system." See § 1.12(b).
[359] Walz v. Tax Comm'n of City of New York, 397 U.S. 664 (1970). See § 1.12(a).
[360] Camps Newfound/Owatonna, Inc. v. Town of Harrison, 520 U.S. 564, 590 (1997).

give residents an advantage in the marketplace is prohibited by the Commerce Clause."[361] In this case, appellee's claim that its "discriminatory tax scheme should be viewed as a permissible subsidy is therefore unpersuasive."[362]

Both dissents assumed that the state real estate tax exemption was a subsidy for purposes of Commerce Clause analysis. At the outset of his dissent, a justice wrote that the state "exempts from its otherwise generally applicable property tax, *and thereby subsidizes*, certain charitable organizations that provide the bulk of their charity to [the state's] own residents."[363] Later, he wrote that this tax exemption is "in truth, no different than a subsidy paid out of the State's general revenues."[364]

Another justice wrote that the state statute at issue "is a narrow tax exemption, designed merely to compensate *or subsidize* those organizations that contribute to the public fisc by dispensing public benefits the State might otherwise provide."[365] He not-so-subtly alluded to this subsidy concept when he wrote that the exemption "is no more an artifice of economic protectionism than any state law which dispenses public assistance only to the State's residents."[366] He returned to his clarity on the point when he wrote: "If, however, a State that provides social services directly *may* limit its largesse to its own residents, I see no reason why a State that chooses to provide some of its social services indirectly—by compensating *or subsidizing* private charitable providers—cannot be similarly restrictive."[367] He further noted that tax exemptions "are nothing but compensation to private organizations for their assistance in alleviating the State's burden of caring for its less fortunate residents."[368]

(e) Establishment Clause Standing Case

The Supreme Court held that taxpayers challenging a state tax credit on Establishment Clause grounds lacked the requisite standing to sue.[369] This law provides tax

[361] *Id.* at 590.
[362] *Id.* at 591.
[363] Camps Newfound/Owatonna, Inc. v. Town of Harrison, 520 U.S. 564, 609 (1997) (emphasis added).
[364] *Id.* at 640. In this passage, however, the justice did not say that the tax exemption *is* a subsidy but rather that it is "no different than" (that is, is essentially the same as) a subsidy, making it a parallel but not identical concept—a slight distinction, to be sure.
[365] *Id.* at 598 (emphasis added).
[366] *Id.* at 603.
[367] *Id.* at 605 (first emphasis in original; second emphasis added).
[368] *Id.* at 606. This justice added: "In my view, the provision by a State of free public schooling, public assistance, and other forms of social welfare to only (or principally) its own residents—whether it be accomplished directly or by providing tax exemptions, cash, or other property to private organizations that perform the work for the State—implicates none of the concerns underlying our negative Commerce Clause jurisprudence" (*id.* at 607–608).

Also: "But the principle involved in our disapproval of [the state's] exemption limitation has broad application elsewhere. A State will be unable, for example, to exempt private schools that serve its citizens from state and local real estate taxes unless it exempts as well private schools attended predominantly or entirely by students from out of State. A State that provides a tax exemption for real property used exclusively for the purpose of feeding the poor must provide an exemption for the facilities of an organization devoted exclusively to feeding the poor in another country. These results may well be in accord with the parable of the Good Samaritan, but they have nothing to do with the Commerce Clause." *Id.* at 608–609.
[369] Arizona Christian School Tuition Organization v. Winn, 131 S. Ct. 1436 (2011).

credits for contributions to school tuition organizations (STOs), which use the gift funds to provide scholarships to students attending private schools, including religious schools. In general, the Court held there is no standing because of lack of the necessary causation, in that the taxpayers "have not shown that any interest they have in protecting the State Treasury would be advanced."[370]

The taxpayers relied on an exception to the general standing requirement enunciated by the Court in 1968.[371] This exception requires that there be a "logical link" between a plaintiff's taxpayer status and the "type of legislative enactment attacked," plus a "nexus" between a plaintiff's taxpayer status and the "precise nature of the constitutional infringement alleged."[372] For the reasons discussed next, the STO tax credit was held to "not [be] tantamount to a religious tax or to a tithe and does not visit the injury identified in" the law underlying this exception.[373]

The core of the taxpayers' position was that the STO tax credit is, for purposes of this exception, "best understood as a government expenditure."[374] That understanding, wrote the Court majority, is "incorrect."[375] The Court stated that "tax credits and governmental expenditures do not both implicate individual taxpayers in sectarian activities."[376] The Court said that a "dissenter whose tax dollars are 'extracted and spent' knows that he has in some small measure been made to contribute to an establishment in violation of conscience."[377] It added: "When the government declines to impose a tax, by contrast, there is no such connection between dissenting taxpayer and alleged establishment."[378] Also: "And awarding some citizens a tax credit allows other citizens to retain control over their own funds in accordance with their own consciences."[379]

The Court majority ended with this:

> *Like contributions that lead to charitable tax deductions, contributions yielding STO tax credits are not owed to the State and, in fact, pass directly from taxpayers to private organizations. Respondents' contrary position assumes that income should be treated as if it were government property even if it has not come into the tax collector's hands. That premise finds no basis in standing jurisprudence. Private bank accounts cannot be equated with [a state's] [t]reasury.*[380]

(f) Other Litigation as to Subsidy Issue

The most radical of the cases decided by a court other than the Supreme Court, on the matter of tax exemptions and charitable deductions as forms of government support, was authored in 1972.[381] In this case, charitable deductions were held to be

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[370] *Id.* at 1444.
[371] Flast v. Cohen, 392 U.S. 83 (1968).
[372] *Id.* at 102.
[373] Arizona Christian School Tuition Organization v. Winn, 131 S. Ct. 1436, 1447 (2011). See § 8.12.
[374] *Id.*
[375] *Id.*
[376] *Id.*
[377] *Id.*
[378] *Id.*
[379] *Id.*
[380] *Id.* at 1448.
[381] McGlotten v. Connally, 338 F. Supp. 448 (D.D.C. 1972).

akin to *matching grants* from government and a grant of *federal financial assistance*, and some tax exemptions were also held to be grants of federal financial assistance.

This case, brought by an individual denied, on the basis of race, membership in a tax-exempt fraternal organization, sought an injunction to prevent the federal government from recognizing the tax exemption of, and allowing deductible gifts (where allowable) to, fraternal entities and social clubs that engage in racial discrimination. The court cast the matter as a challenge to the constitutionality of various federal tax law provisions to the extent that they authorize the "grant of Federal tax benefits" to organizations that racially discriminate in their membership policies.[382] The court, observing that "[e]very deduction in the tax laws provides a benefit to the class who may take advantage of it,"[383] added that "[t]here is no question that allowing the deduction of charitable contributions in fact confers a benefit on the organization receiving the contribution," regarding the "impact" of the benefit as a "matching grant."[384] With use of the charitable deduction, wrote this court, the "government has marked certain organizations as '*Government Approved*' with the result that such organizations may solicit funds from the general public on the basis of that approval."[385]

This court analyzed the tax exemptions for social clubs and fraternal organizations. The exemption for social clubs is a limited one, in that all club income is taxable other than *exempt function income*, which essentially is income from club members.[386] The court concluded that this exemption for exempt function income "does not operate to provide a grant of federal funds through the tax system," in that this body of law is "part and parcel of defining appropriate subjects of taxation."[387] The court added that, with the social club tax exemption, "there is no mark of Government approval inherent in the designation of a group as exempt" and that

[382] *Id.* at 455.
[383] *Id.* at 456.
[384] *Id.* at 456, note 37, citing the court's decision two years before that a charitable deduction is the equivalent of a matching grant (Green v. Kennedy, 309 F. Supp. 1127, 1136 (D.D.C. 1970)).
[385] McGlotten v. Connally, 338 F. Supp. 448, 456 (D.D.C. 1972) (emphasis by the court). This was not only hyperbole but it was error. The court, in trying to rationalize why a charitable contribution deduction is more of a form of government support than most other deductions, wrote that a "contribution, even for an approved purpose, is deductible *only* if made to an organization of the type specified in [IRC] § 170 and which has obtained a ruling or letter of determination from the Internal Revenue Service" (*id.*) (emphasis by the court). The first half of that sentence is accurate; the second half, however, is not. That is, many religious organizations and small charitable organizations are eligible to receive deductible charitable contributions, even though these entities are not required to secure a determination letter or ruling from the IRS. See *Law of Tax-Exempt Organizations* § 25.2(b).

The court highlighted its distinctions by writing that most deductions "go no further than simply indicating the activities hoped to be encouraged" (*id.* at 457). By contrast, the charitable deduction at issue "expressly choose fraternal organizations as a vehicle for that activity" and "allow[s] such organizations to represent themselves as having the imprimatur of the Government" (*id.*). (Charitable organizations, of course, do no such thing.) The court concluded this line of reasoning with the thought that "[t]his seems to us a significant difference of degree in an area where no bright-line rule is possible" (*id.*).

Another district court rejected the idea that a grant of tax-exempt status connotes approval by the government involved of the exempt organization or its policies (Stewart v. New York Univ., 430 F. Supp. 1305, 1312 (S.D.N.Y. 1976)).
[386] See *Law of Tax-Exempt Organizations* § 15.5.
[387] McGlotten v. Connally, 338 F. Supp. 448, 458 (D.D.C. 1972).

"Congress has simply chosen not to tax a particular type of revenue because it is not within the scope sought to be taxed by the statute."[388]

The tax exemption for fraternal organizations, wrote the court, "stands on different footing," in that these organization are generally exempt, being taxable only on their unrelated business income.[389] The "crucial impact of this differential treatment," said the court, "is that the passive investment income of fraternal orders is not taxed."[390] The court concluded: "Here individuals are providing funds which are then invested for the purposes of benefiting the contributing members, and the exemption of this income is a 'benefit' provided by the Government."[391]

The court then considered whether these tax exemptions and charitable deductions constitute *federal financial assistance* as that phrase is defined for purposes of the Civil Rights Act of 1964. That term means "assistance to any program or activity, by way of grant, loan, or contract other than a contract of insurance or guaranty."[392] The court wrote that "there is little question" that the provision of a tax deduction for charitable contributions is a grant of federal financial assistance under that definition, in that it "operates in effect as a Government matching grant and is available only for the particular purposes and to the particular organizations outlined in the Code."[393] The tax exemption for social clubs was held to not be a grant of federal financial assistance, in that this exemption, "limited as it is to member-generated funds and available regardless of the nature of the activity of the particular club, does not operate as a 'grant' of Federal funds."[394] By contrast, the exemption for fraternal organizations was held to be a grant of federal financial assistance inasmuch as the exemption embraces "passive investment income" and is "available only to particular groups," thereby operating "as a subsidy in favor of the particular activities these groups are pursuing."[395]

Another federal district court observed, in passing, that tax-exempt status is a "federal subsidy."[396] Other federal district courts, however, have rejected the assertion that "tax benefits" in the form of tax exemptions and charitable deductions are sufficient forms of government support to support plaintiffs' claims. One court held that these tax benefits cannot support a civil rights claim based on racial discrimination (in the context of a university's affirmative action program[397]).[398] Another court wrote that, "[a]though tax exempt status confers a substantial economic advantage" on exempt organizations, "not every item of economic value granted by the federal

[388] *Id.*
[389] See *Law of Tax-Exempt Organizations* § 19.4.
[390] McGlotten v. Connally, 338 F. Supp. 448, 459 (1972).
[391] *Id.*
[392] 42 U.S.C. § 2000d-1.
[393] McGlotten v. Connally, 338 F. Supp. 448, 462 (1972) (internal footnotes omitted).
[394] *Id.* (footnote omitted).
[395] *Id.* As to the concept of *federal financial assistance* (see *supra* note 392), the Court wrote that the federally provided air traffic control system, which is "owned and operated" by the U.S. government, is not a form of federal financial assistance but rather is a "federally conducted program that has many beneficiaries but no recipients" (Dep't of Transportation v. Paralyzed Veterans of America, 477 U.S. 597, 612 (1986)).
[396] Fulani v. League of Women Voters Education Fund, 684 F. Supp. 1185, 1192 (S.D.N.Y. 1988), *aff'd on other issues*, 882 F.2d 621 (2nd Cir. 1989).
[397] See § 1.8(d).
[398] Stewart v. New York Univ., 430 F. Supp. 1305, 1314 (S.D.N.Y. 1976).

government counts as financial assistance."[399] Still another court concluded that tax exemptions and charitable deductions are "indirect . . . subsidies" and that exemption from taxation is not a form of federal financial assistance.[400]

(g) Tax Expenditures

In connection with a Senate Finance Committee hearing on the state of the federal tax law, the staff of the Joint Committee on Taxation prepared an analysis of the tax expenditure concept.[401] This report observed that, in general, tax exemption (such as for charities) is not considered a tax expenditure because the "nonbusiness activities of such organizations generally must predominate and their unrelated business activities are subject to tax." Tax exemption for organizations that compete with for-profit organizations (such as exempt credit unions), however, is a tax expenditure, as are exceptions to the unrelated business rules. Nonetheless, some critics of tax-exempt organizations are advocating determination of the value of nonprofit tax exemptions in general, in effect urging that exemption in general for nonprofit organizations be considered a tax expenditure (and thus a subsidy).

The current estimates of federal tax expenditures, prepared by the staff of the Joint Committee on Taxation, are for the government's fiscal years 2011 through 2015.[402] In this analysis, the five-year federal charitable contribution deduction tax expenditure totaled $242.6 billion, making it the fifth largest of these expenditures. Of this total, $32.4 billion pertain to deductions for education purposes and $24.1 billion for health purposes.

To place this in perspective, the other large tax expenditures are as follows:

- Exclusion of employer contributions for health care, health insurance premiums, and long-term care insurance premiums—$725 billion.
- Net exclusion of pension contributions and earnings in connection with employee plans—$718.3 billion.
- Deduction for mortgage interest on owner-occupied residences—$464.1 billion.
- Reduced rates of tax on dividends and long-term capital gains—$456.6 billion.
- Exclusion of capital gains at death—$230.8 billion.
- Exclusion of benefits provided under cafeteria plans—$197.6 billion.
- Exclusion of capital gains on sales of principal residences—$123.2 billion.
- Deduction for real property taxes—$117.1 billion.
- Exclusion of scholarship and fellowship income—$12.6 billion.

[399] Bachman v. Amer. Soc'y of Clinical Pathologists, 577 F. Supp. 1257, 1263 (D. N.J. 1983). This court added that the concept of *assistance* "connotes a transfer of government funds by way of subsidy, not merely an exemption from taxation" (*id.* at 1264).

[400] Johnny's Icehouse, Inc. v. Amateur Hockey Ass'n of Illinois, 134 F. Supp. 2d 965, 972 (N.D. Ill. 2001). As to the latter, the court wrote that the concept of federal financial assistance "encompasses only direct transfers of federal money, property or services from the government to a program" (*id.*).

[401] "Background Information on Tax Expenditure Analysis and Historical Survey of Tax Expenditure Estimates" (JCX-15-11) (February 15, 2011).

[402] JCS-1-12 (January 17, 2012).