Calhoun Academy,v. Commissioner
UNITED STATES TAX COURT
94 T.C. 284
March 1, 1990

[****] The issue for decision is whether petitioner has a racially nondiscriminatory policy as to students.

[****]

Petitioner, The Calhoun Academy, with its principal office located in St. Matthews, Calhoun County, South Carolina, was organized as a nonprofit corporation in South Carolina on December 30, 1969. Petitioner's certificate of incorporation of that date states its purpose as --

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Since the 1970-71 school year, petitioner has operated an independent private school in Calhoun County for grades 1 through 12. The school also now has a kindergarten class. [****]

Since opening its doors in 1970, petitioner has never had a black student enrolled. A black student has in fact never applied for admission. On two occasions, however, both during the 1984-85 school year, petitioner provided an application form to a black parent. Petitioner has also never had, or received an employment application from, a black teacher. [****]

Prior to 1982, petitioner had no minority students, black or otherwise, and no minority teachers. (As used herein, "minority" has its commonly understood meaning in the racial context, namely "other than Caucasian." We recognize, however, that the whites in Calhoun County, who total less than half of the population, are statistically a minority group relative to the total population of the county.) Since 1982 petitioner has had at least one "American-Oriental" student, but no representatives of other minorities. During the 1986-87 school year, petitioner had two American-Oriental students and two more were accepted for admission for the following school year. In 1983 petitioner hired its first and only minority teacher, who is of "Japanese-American" descent.

[****]

Petitioner never publicly announced a racially nondiscriminatory policy toward students prior to November of 1985. As certified by the secretary of state of South Carolina on November 27, 1985, petitioner's charter was formally amended as follows:

RESOLVED, that The Calhoun Academy, Inc, shall admit students of any race, color, national or ethnic origin to all the rights, privileges, programs and activities generally accorded or made available to students at the school. It shall not discriminate on the basis of race, color, national and ethnic origin in administration of its educational policies, admissions policies, scholarship and loan programs, and athletic and other school administered programs.

[****]

In the May 15, 1986, edition of the Calhoun Times, a local weekly newspaper read by all racial segments of the community, petitioner announced that it was accepting applications for the upcoming school year. A statement in relatively fine print at the bottom of the notice read: "Calhoun Academy Has A Non-Discriminatory Policy In Regard To Race, Creed, Color or National Origin."

[****]

Despite its limited employment and enrollment experience with minorities, petitioner has never been a party to any litigation involving a claim of racial discrimination.

[****]

In the economic area served by Calhoun Academy there are few professional people among minority groups. * * * Most members of minority groups are blue collar workers and the few white collar jobs are primarily in public education. The children of these professional people attend the schools in which their parents teach and administer. * * *

[****]

On June 17, 1986, petitioner filed an application with respondent, requesting an exemption from Federal income tax as an organization described in section 501(c)(3). [****]

After requesting and receiving detailed information concerning petitioner's race-related policies and practices, the Internal Revenue Service (Service) national office tentatively denied petitioner's application by letter dated April 21, 1987. The letter emphasized petitioner's formation at the time of enforced desegregation in the local public schools, its total absence of black students despite a sizable local black population, and its failure to adopt and publicly announce a racially nondiscriminatory policy until 1985. According to the letter, petitioner had not overcome this cumulative inference of racial discrimination:

[****]

Rev. Proc. 75-50, 1975-2 C.B. 587, describes detailed guidelines and recordkeeping requirements to be used in determining whether a private school that applies for a section 501(c)(3) exemption has a racially nondiscriminatory policy. The burden placed upon applicants is broadly stated as follows:

A school must show affirmatively both that it has adopted a racially nondiscriminatory policy as to students that is made known to the general public and that since the adoption of that policy it has operated in a bona fide manner in accordance therewith. [*1975-2 C.B. at 587.]*

Subject to limited exceptions, *Rev. Proc. 75-50* specifically requires, among other things: (1) A statement in the governing instrument of the school that it has a racially nondiscriminatory policy as to students; (2) a similar statement in school brochures, catalogs, and written advertising; (3) publicizing of the policy, through print or broadcast media, to all racial segments of the community served by the school; (4) an annual certification that the school is in conformance with relevant parts of the revenue procedure; and (5) retention of specified records for a minimum of 3 years.

[****]

The parties agree that the burden of proof in this proceeding rests with petitioner under Rule 217(c)(2). There appears to be some confusion, however, as to what the burden-of-proof standard is. We have previously defined the burden applicable to sections 7428 and 501(c)(3) as proof by a **preponderance of the evidence**. [****]

Respondent on brief disavows the applicability of a heightened standard in this case. Nonetheless, respondent's letter to petitioner of April 21, 1987, expressly states: "A private school with a history of racial discrimination must provide clear and convincing evidence that it no longer discriminates on the basis of race." (Emphasis in original.) This sentence standing alone speaks of an abstract private school, with no direct reference to petitioner. From the context, however, there is little doubt that the sentence is meant to apply specifically to petitioner. In this regard, we note that the next paragraph of the letter, clearly addressing petitioner, refers to "your history of racial discrimination." (Emphasis in original.) See also General Counsel's Memorandum 39525 (July 1, 1986) ("Private schools seeking recognition of exempt status bear the burden of affirmatively establishing bona fide operation consistent with a policy of nondiscrimination by clear and convincing evidence."); General Counsel's Memorandum 39524 (July 1, 1986); General Counsel's Memorandum 39754 (September 8, 1988).

"Clear and convincing" language has sometimes appeared in cases, of other courts, that involve private schools and racial discrimination issues. In *Norwood v. Harrison, 382 F. Supp. 921 (N.D. Miss. 1974),* the court addressed itself to private schools wanting to borrow textbooks owned by the State of Mississippi. To respect constitutional constraints, the court sought to disqualify those schools that racially discriminated. The court focused on private

schools, formed or expanded at the time of public school desegregation, that had a continuing absence of black students and teachers. These private schools bore a presumption of racial discrimination that could be rebutted only by evidence that would "clearly and convincingly reveal objective acts and declarations establishing that the absence of blacks was not proximately caused by such school's policies and practices." *382 F. Supp. at 926.*

The court in *Brumfield v. Dodd, 425 F. Supp. 528 (E.D. La. 1976),* considered a similar constitutional issue for private schools seeking assistance from the State of Louisiana in the form of textbooks, classroom materials, and transportation financing. The court quoted extensively from *Norwood v. Harrison, supra,* and expressly relied on the burden-of-proof analysis therein. *Brumfield v. Dodd, 425 F. Supp. at 531-532.*

Similar principles have been applied to section 501(c)(3). In Green v. Miller, an unreported case (*D.D.C. 1980, 45 AFTR 2d 80-1566, 80-1 USTC par. 9401),* the court supple mented and modified an outstanding permanent injunction relating to the tax-exempt status of Mississippi private schools. For a school bearing an inference of racial discrimination, the inference "may be overcome by evidence which clearly and convincingly reveals objective acts and declarations establishing that such is not proximately caused by such school's policies and practices." *45 AFTR 2d at 80-1567, 80-1 USTC at 84,089.*

We are not compelled to reconcile the "clear and convincing" language of these cases with the standard we find applicable here, a preponderance of the evidence, because these cases arose under neither section 7428 nor Rule 217. Indeed, *Norwood v. Harrison, supra,* and *Brumfield v. Dodd, supra,* address constitutional issues that are not before us in the instant case. Although Green v. Miller, supra, relates directly to section 501(c)(3), the focus of the injunction is at the administrative level, specifically the Service determination of tax-exempt status, rather than the judicial review stage.

We note further that the effects of the two formulations may be practically equivalent because of the differing points at which unfavorable inferences enter into the analysis. The "clear and convincing" standard, as described in these cases, applies on rebuttal only after an inference of racial discrimination has taken hold. The "preponderance of the evidence" standard, in contrast, begins with a clean evidentiary slate. A taxpayer faced with an unfavorable evidentiary inference at the outset plainly bears a heavier burden from that point forward, however articulated, than a taxpayer with no such unfavorable inference yet established.

Concerning what petitioner must prove, its burden in this proceeding, in broad terms, is to establish that it has a racially nondiscriminatory policy as to students. *Bob Jones University v. United States, supra.* More precisely, petitioner must show that it has adopted a racially nondiscriminatory policy as to students and operates in good faith in accordance with that policy. See *Virginia Education Fund v. Commissioner, 85 T.C. at 748.* If adoption of the policy is defined to mean adoption in substance rather than merely in form, then the adoption and operation elements are largely redundant. Adoption in form also does not reasonably stand as a separate element, instead serving most appropriately as a fact that contributes to an inference of good faith operation in a racially nondiscriminatory manner. Therefore, to have a separate and meaningful existence, the adoption element must be something more than adoption in form, yet something less than adoption in substance. Specifically, we define the adoption element to require more than mere adoption in form on the books of the organization. The adoption element requires adoption of a nondiscriminatory policy in form on the books of the organization, coupled with appropriate publicity and notification to the various relevant groups in the community so that adoption of the policy is known publicly.

[****]

With respect to the adoption of a racially nondiscriminatory policy, as we have

defined it above, we find that petitioner has met its burden of proof. [****]

Whether or not petitioner operates in good faith in accordance with its stated policy is a more complicated question. [****]

Clearly, if we were to find that petitioner publicized a nonexistent policy to attain tax-exempt status, petitioner could not prevail here. However, if we were to find that petitioner in good faith first implemented the policy in 1985 in order to become tax-exempt, this would not preclude a favorable determination for petitioner. Section 508(a) ensures that petitioner's tax-exempt status under section 501(c)(3) would not be retroactive to any period of racial discrimination. Moreover, we have acknowledged the right of an organization to show that it has mended its ways. *Virginia Education Fund v. Commissioner, 85 T.C. at 748.* See also *Prince Edward Sch. Foundation v. United States, 478 F. Supp. at 112, 450 U.S. at 946* (Rehnquist, J., dissenting from denial of cert.).

As already noted, petitioner has no direct evidence that it operates in accordance with a racially nondiscriminatory policy as to black students, at least from the application evaluation stage forward. Consequently, from petitioner's indirect evidence we must be able to draw the inference that petitioner would operate in a nondiscriminatory manner when considering the application of a black child or when administering school policies for an already enrolled black student.

Petitioner points out that it has provided to a black parent, on the only two occasions requested, an application for admission. We note, however, that the application distribution stage of the admissions process is not the time when discrimination would necessarily manifest itself. Indeed, distributing application forms on request to members of a disfavored group is a harmless, empty gesture for a discriminatory school if the school feels confident that a completed application will not be submitted. A school reaches a meaningful decision point only when faced with a submitted application. Petitioner's "by request only" distribution policy ensures a lack of widespread distribution. Because of the small number involved here, we attach little weight to petitioner's distribution of application forms to two black parents.

Petitioner places great emphasis on its teacher and students of Oriental descent, labeling this evidence "perhaps the most telling." Petitioner has hired and continued to employ a Japanese-American teacher, who has been subjected to no discriminatory practices since his hiring. Petitioner has also admitted some American-Oriental students. Nonetheless, that petitioner does not discriminate against those of Oriental descent, which we assume to be true for present purposes, implies nothing about petitioner's policy toward blacks. Petitioner concedes that the largest nonwhite racial group in the local community is the black population. Petitioner's argument that American-Orientals are "more of a minority than blacks," while certainly true for Calhoun County, is totally without significance here. We decline to embrace the notion, grounded in an erroneous application of a fortiori logic, that acceptance of a given minority group implies acceptance of all larger minority groups.

In addition to the two application forms provided to black parents, petitioner relies on its interaction with blacks in other schools and the surrounding community to prove that it follows its stated nondiscriminatory policy.

In today's world, interaction with persons of another race in interscholastic and community activities is unavoidable by all but the most reclusive or isolated groups. Petitioner's burden is not met by showing that it interacts with outsiders. The relevant criteria deal with restrictions on those who may become insiders, i.e., students at the school.

Petitioner seeks to explain its total absence of black students on two principal grounds, economics and the quality of the local public schools.

Petitioner asserts that Calhoun County families, "both black and white," typically cannot afford petitioner's fees. Statistics in the record, without a breakdown by race,

confirm that petitioner's fees would cause a financial hardship to most families, even with only one child enrolled. This does not explain, of course, how the parents of over 400 white students are able to afford petitioner's private schooling every year. Petitioner addresses this point by representing that local blacks generally are economically disadvantaged relative to whites. Petitioner admits, however, that there are some professional people among the local black population:

In the economic area served by Calhoun Academy there are few professional people among minority groups. * * * Most members of minority groups are blue collar workers and the few white collar jobs are primarily in public education. The children of these professional people attend the schools in which their parents teach and administer. * * * [Emphasis added.]

Thus, economics alone cannot explain the total absence of black applicants over a span of 17 school years, or even over the 2 school years since petitioner's announcement of a racially nondiscriminatory policy.

Petitioner's other principal justification for a lack of black students is that the quality of the local public schools is in some respects superior to that of petitioner. Statistics in the record show that the local public schools have better paid teachers and significantly higher expenditures per pupil. In addition, a new public high school was constructed recently. These would certainly be meaningful explanatory facts if petitioner's hallways and classrooms were empty. Unexplained, however, is why over 400 white students annually forgo the quality education in the public schools.

Petitioner suggests that it prepares students better for college and other postsecondary education, and states that "it is likely that at least some parents (both black and white) have not sent their children to * * * [petitioner] because they knew that their children were unlikely to go on to college." This assertion is speculative and does not explain the total absence of black students at petitioner's school.

On brief, petitioner suggests another reason for its success in attracting local students:

It is likely that Petitioner's strict rules and procedures provide a better regimen for learning than in the public schools. Certainly the parents of children enrolled at Petitioner send their children there to be inculcated with the fundamental values of discipline, hard work and respect for others, in addition to learning their "ABCs." * * * It is Petitioner's approach to teaching young children that permits Petitioner to continue to attract students year after year.

If meant to explain the absence of black students, this explanation exhibits the same deficiencies as petitioner's statement about its superior college preparation. This "better regimen for learning" undercuts petitioner's more central argument about the relatively high quality of the local public schools. Further, there is nothing in the record to suggest that "strict rules and procedures" appeal more to the local white students and their parents than the local blacks.

In sum, at least some of the black parents in the local community have the financial resources to send their children to petitioner and at least some of the public school black students go on to higher education. Combining these two facts suggests that petitioner, if it truly has a racially nondiscriminatory policy, should have received some applications from black students after November of 1985.

Respondent's representatives, at the conference with petitioner's representatives on August 25, 1987, suggested that petitioner correspond directly with black community leaders about a nondiscriminatory policy, contact placement offices of black colleges about available teaching positions, and reduce tuition for some black students. By letter dated November 5, 1987, one of petitioner's board members stated that petitioner would not offer a tuition reduction plan for black students. The letter also stated that the other two suggestions had been discussed, but that a final decision on those had not yet been made. Petitioner did not inform respondent of a final decision on these two

items, one way or the other, prior to respondent's final adverse ruling letter dated February 26, 1988.

In our view, a private school generally may meet its burden of proof under section 501(c)(3) without establishing that it took affirmative steps on its own initiative to attract students and teachers of underrepresented races. [****]

This definition on its face forbids negative racial practices rather than demands positive ones. Standing alone, therefore, this definition cannot reasonably be read to require the activities suggested by respondent's representatives.

The Supreme Court has expressed its approval of the rationale in *Rev. Rul. 71-447* without attempting to extend it. *Bob Jones University v. United States, 461 U.S. at 595, 601-602.* Granted, the facts before the Supreme Court did not raise an affirmative action issue because both subject schools discriminated within the *Rev. Rul. 71-447* definition. *461 U.S. at 605.* **The Supreme Court emphasized, however, that an institution should be deemed not charitable under its analysis only when there can be "no doubt" that the activity involved is contrary to a fundamental public policy.** *461 U.S. at 592, 598.* Declining to take affirmative steps to seek out black students and teachers does not fall within this standard. See Farber, "Statutory Interpretation, Legislative Inaction, and Civil Rights," *87 Mich. L. Rev. 2, 17 (1988):*

There is much dispute in our society about how the norm of racial equality should be applied in connection with issues such as affirmative action. But the core equality norm -- that intentional discrimination against racial minorities is impermissible -- is surely not in dispute. [Fn. refs. omitted].

A conclusion that a private school generally is not required to take the specific affirmative acts suggested by respondent, however, does not equate with a conclusion that petitioner on the record in the instant case has satisfied its burden of proving that its operations qualify for tax-exempt status. Petitioner's evidence, in summary, is that it adopted a formal statement of nondiscrimination and did not insulate itself from interaction with black outsiders. This evidence is insufficient to preponderate in favor of a finding that it operated in a racially nondiscriminatory manner. The absence of either a single black student in the school or a plausible explanation of inability to attract black students permits an inference of discrimination, particularly in view of petitioner's history. **In order to prevail, petitioner must have done something to overcome the unfavorable inferences that may be drawn from the record in the instant case. Petitioner's taking of affirmative steps of some sort (not necessarily those suggested by respondent's representatives) might have been appropriate to overcome the effect of the evidence in the record that is unfavorable to this petitioner.**

From the record before us, it appears that white students and their parents gravitate to petitioner at least in part because of a historical absence of black students: petitioner admits that the local public schools are superior in material respects, yet considerably less expensive. Petitioner's survival would thus depend to some extent on perpetuating its history. Overt racial discrimination, however, would clearly preclude section 501(c)(3) tax-exempt status and the corresponding financial benefits. *Bob Jones University v. United States, supra.* See also *Runyon v. McCrary, 427 U.S. 160 (1976).* A private school with similar pressures could attempt to satisfy everyone by having an abstract nondiscriminatory policy, but with no significant efforts to attract blacks. If local blacks show little interest in attending the school, an intermediate result of the school's strategy would be little or no evidence of the policy in action. The ultimate result in this type of proceeding, and the danger for a school steering this balancing course, could very well be that the school fails in its burden of proof.

After a comprehensive review of the administrative record, we find that petitioner has not carried its burden to show that it operates in good faith in accordance with a racially nondiscriminatory policy as to students.