

UCLA

UCLA Public Law & Legal Theory Series

Title

The University, Ideology, and Tax Exemption

Permalink

<https://escholarship.org/uc/item/42q3b40d>

Journal

Tax Notes Federal

Authors

Aprill, Ellen P

Brunson, Samuel D

Publication Date

2020-04-10



Loyola Law School
Loyola Marymount University
Los Angeles

Legal Studies Paper No. 2020-24

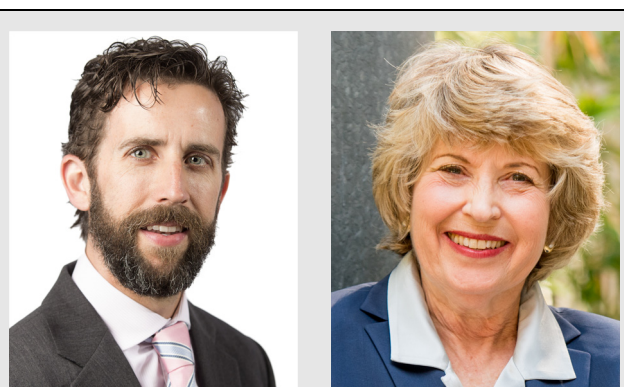
Tax Notes Federal (August 2020)

The University, Ideology, and Tax Exemption

Professor Ellen P. Aprill

The University, Ideology, and Tax Exemption

by Samuel D. Brunson and Ellen P. Aprill



Samuel D. Brunson



Ellen P. Aprill

Samuel D. Brunson is the Georgia Reithal Professor of Law at Loyola University Chicago School of Law. Ellen P. Aprill is a professor of law and the John E. Anderson Chair in Tax Law at Loyola Law School Los Angeles.

In this article, Brunson and Aprill argue that the tax law and other considerations undermine President Trump's position that academic institutions can lose their tax-exempt status as a consequence of indoctrinating their students with liberal values.

Copyright 2020 Samuel D. Brunson and
Ellen P. Aprill.
All rights reserved.

On the morning of July 10, President Trump tweeted:

Too many Universities and School Systems are about Radical Left Indoctrination, not Education. Therefore, I am telling the Treasury Department to re-examine their Tax-Exempt Status and/or Funding, which will be taken away if this Propaganda or Act Against Public Policy continues. Our children must be Educated, not Indoctrinated!

His tweet responded to opposition many universities expressed to the administration's announced policy that foreign students would have to take at least one in-person class or else be denied permission to stay in the United States under a student visa.¹ In response to the new policy, several universities filed suits against the administration.²

Trump's tweet set off a firestorm of reactions. ABC News contextualized the president's tweets as part of a long-standing conservative history of "attacking universities perceived as liberal."³ *Politico* implicitly agreed, reporting that the president's tweets capped a "weeklong drive to turn education into a political wedge issue."⁴ *The Atlantic* argued that the embedded threat in the tweet represented "a bona fide threat against First Amendment speech itself, trying to use the power of the government to punish people whose expression he finds objectionable."⁵

The president's tweets did represent an implicit political threat against free speech. Although the administration ultimately backed off its threat against foreign students,⁶ the

¹ See Anemona Hartocollis and Miriam Jordan, "As Universities Seek to Block Visa Rules, Trump Threatens Tax Status," *The New York Times*, July 10, 2020.

² On July 8 Harvard and MIT filed a lawsuit against the Department of Homeland Security challenging the administration's new policy on foreign students. On July 10 Johns Hopkins filed a similar lawsuit. On that same day, the Regents of the University of California filed a lawsuit challenging the administration's policy. On July 14, however, DHS rescinded these rules. See Michelle Hackman, Melissa Korn, and Andrew Restuccia, "Trump Administration Rescinds Rules on Foreign Student Studying Online," *The Wall Street Journal*, July 14, 2020.

³ Ben Gittleson, "Trump Targets Tax-Exempt Status for Schools, Universities," ABC News (July 10, 2020). House ways and Means Committee Chair Richard E. Neal, D-Mass., also wanted further review. (Related coverage: p. 1098.)

⁴ Juan Perez Jr., "Trump Tweet Threatens Tax-Exempt Status of Schools, Colleges," *Politico*, July 10, 2020.

⁵ David A. Graham, "What a Direct Attack on Free Speech Looks Like," *The Atlantic*, July 10, 2020.

⁶ Hackman, Korn, and Restuccia, *supra* note 2.

president's tweets nonetheless offer an opportunity to reexamine the rules applicable to tax-exempt organizations, especially the rules applicable to educational institutions such as colleges and universities. Under the applicable rules — both general ones and those applicable to educational institutions in particular — these institutions would remain eligible for exemption, even if we assume that the president is right that universities are in effect indoctrinating students with liberal values.⁷

General Rules for 501(c)(3)s

Under the Internal Revenue Code, corporations “organized and operated exclusively for . . . educational purposes” may qualify as exempt from income taxation.⁸ Like other organizations exempt under section 501(c)(3), educational entities must meet some general rules that apply to all organizations seeking tax exemption under that subsection. Those general rules include three broad limitations on what any organization exempt under section 501(c)(3) can do. The first forbids private inurement. That is, to qualify as tax exempt, an organization cannot distribute part or all of its net earnings to private shareholders or individuals and cannot otherwise allow such persons to benefit from its net earnings.⁹ Opposition to the visa policy does not implicate this prohibition.

The second limitation is on lobbying. “No substantial part” of an exempt organization’s activities can be “carrying on propaganda, or otherwise attempting, to influence legislation.”¹⁰ The Treasury regulations clarify that this limitation prohibits a tax-exempt organization

from devoting more than an “insubstantial part of its activities” to influencing legislation.¹¹ No bright line separates insubstantial activities from substantial activities, and courts tend to address substantiality on an ad hoc basis.¹² Still, section 501(c)(3) clearly permits EOs to participate to some extent in the political process by lobbying for legislation.¹³

This test is quantitative and not based on content. Too much lobbying, whatever its subject, can lead to loss of exemption.¹⁴ The activities of universities opposing the foreign student visa rules — whether in the form of letters, statements, suits, or amicus briefs — would not amount to substantial activity under the lobbying rules, even if they did constitute lobbying.

But the universities’ opposition to the new visa policy does not constitute lobbying for purposes of section 501(c)(3). Trump’s tweet uses the word “propaganda,” as does section 501(c)(3), but the code’s use of that term refers to attempts to influence legislation, not to opposing executive actions.¹⁵ Thus, the lobbying limitation does not come into play in this dispute.

The third limitation prohibits endorsing or opposing candidates for office, directly or indirectly.¹⁶ While a tax-exempt section 501(c)(3) organization can engage in insubstantial lobbying activities, permissible political activities do not include candidate endorsements. Critically, the tax law not only prohibits EOs from endorsing or opposing candidates for office, it also prohibits a tax-exempt organization’s articles of incorporation from empowering it to participate

⁷ The president’s assertion is on doubly shaky ground when it comes to state schools. Although many state schools have elected to be exempt under section 501(c)(3), even if they lost that exemption, they would still be exempt from federal taxes as governmental units or affiliates of a governmental unit. See Ellen P. Aprill, “Revising the Federal Tax Treatment of States, Political Subdivisions, and Their Affiliates,” 23 *Fla. Tax Rev.* 72 (2019).

⁸ Section 501(c)(3).

⁹ Reg. section 1.501(c)(3)-1(c)(2) (as amended in 2017).

¹⁰ Section 501(c)(3). Private foundations, however, are for practical purposes prohibited from lobbying because of the excise tax that applies to their doing so. Section 4945(d)(1) and (e).

¹¹ Reg. section 1.501(c)(3)-1(b)(3)(i) (as amended in 2017).

¹² See Samuel D. Brunson, “Reigning in Charities: Using an Intermediate Penalty to Enforce the Campaigning Prohibition,” 8 *Pitt. Tax Rev.* 125, 144 (2011).

¹³ Section 501(c)(3) organizations also have the option of electing to measure their permitted lobbying by specific dollar amounts. Few organizations, especially large ones, make that election because the upper limit for lobbying expenses is \$1 million. See sections 501(h) and 4911.

¹⁴ See *Taxation With Representation v. Regan*, 461 U.S. 540 (1997) (upholding lobbying limits).

¹⁵ See reg. section 1.501(c)(3)-1(c).

¹⁶ Section 501(c)(3).

in political campaigns.¹⁷ That important, albeit controversial,¹⁸ rule is not at issue here.

Educational Purposes

In addition to these general proscriptions, a tax-exempt educational organization must qualify as educational. Under the applicable regulations, an educational organization is one that instructs or trains individuals for the purpose of improving or developing their capabilities, or that instructs the public on useful subjects.¹⁹ As the regulations make clear, universities and schools are quintessential exempt educational organizations.²⁰

“Educational” does not mean viewpoint-neutral. The regulations expressly provide that an educational organization can “advocate a particular position or viewpoint,” as long as it provides a sufficiently “full and fair exposition of the pertinent facts” to allow individuals to come to their own conclusion.²¹ An organization that principally presents unsupported opinion, by contrast, does not qualify as educational.²²

In *Big Mama Rag*,²³ however, the D.C. Circuit held that the “full and fair exposition” standard lacked “sufficient specificity to pass constitutional muster.” It cautioned that criteria for tax exemption must rest “on the basis of criteria capable of neutral application.”²⁴

The IRS responded to that challenge in *National Alliance*,²⁵ which involved the IRS’s denial of exemption for the National Alliance, a white supremacist group. The IRS based its denial on a four-criteria “methodology test.” In upholding the denial, the D.C. Circuit found that the test

reduced the vagueness of the “full and fair exposition” regulation.²⁶

The IRS formalized the methodology test in Rev. Proc. 86-43, 1986-2 C.B. 729.²⁷ Under the revenue procedure, the presence of any of the following four factors indicates that an organization is not educational:

1. a substantial part of the organization’s communications are viewpoints not supported by facts;
2. the facts used to support the conclusion are distorted;
3. presentations use inflammatory and disparaging terms and base conclusions on feelings; or
4. the organization’s approach does not aim to develop an understanding by its audience because it does not take into account the background or training of the audience in the subject matter.

The IRS’s methodology test focuses on the method of delivering information, not the information presented.²⁸

Importantly, the full and fair exposition test, as supplemented by the methodology test, does not require that an educational organization advocating a particular view present and rebut opposing views. The Tax Court’s memorandum opinion in *Nationalist Movement*²⁹ explained that “the IRS does not condition educational status under the revenue procedure on the presentation of opposing views.” The court suggested that this position lessens administrative discretion, because “the IRS is not called upon to evaluate how accurately or completely an organization presents such views.”³⁰ The IRS has continued to limit its administrative discretion. For example, it has granted exempt status to several white

¹⁷ Reg. section 1.501(c)(3)-1(b)(3)(ii) (as amended in 2017).

¹⁸ See Aprill, “Amending the Johnson Amendment in the Age of Cheap Speech,” 2018 U. Ill. L. Rev. Online 1 (Jan. 16, 2018).

¹⁹ Reg. section 1.501(c)(3)-1(d)(3)(i)(B).

²⁰ Reg. section 1.501(c)(3)-1(d)(3)(ii), Example 1.

²¹ Reg. section 1.501(c)(3)-1(d)(3)(i).

²² *Id.*

²³ *Big Mama Rag Inc. v. United States*, 631 F.2d 1030, 1039 (D.C. Cir. 1980).

²⁴ *Id.*

²⁵ *National Alliance v. United States*, 710 F.2d 868, 870 (D.C. Cir. 1983).

²⁶ *Id.* at 875. The court did not address the constitutional question, though, because *National Alliance* did not meet *any* viable definition of educational. *Id.* at 875-876.

²⁷ Rev. Proc. 86-43, section 3.03.

²⁸ See *Parks v. Commissioner*, 145 T.C. 278, 316 (2015), *aff’d sub nom., Parks Foundation v. Commissioner*, 717 F. App’x 712 (9th Cir. 2017).

²⁹ *Nationalist Movement v. Commissioner*, 102 T.C. 558, 586-587 (1994), *aff’d*, 37 F.3d 216 (5th Cir. 1994). The case upheld denial of exemption for a white supremacist organization.

³⁰ *Id.* at 586-587. See also *National Association for Legal Support for Alternative Schools v. Commissioner*, 71 T.C. 118, 123-124 (1978) (providing public with litigation documents filed by opposing parties was an appropriate method of presenting “full and fair exposition”).

nationalist organizations, including the National Policy Institute, whose mission is to publish and disseminate information about the “heritage, identity, and future of people of European descent.”³¹

The detail in the July 8 complaint for declaratory and injunctive relief filed by Harvard and MIT leaves no doubt that it meets the IRS’s methodology test.³² Similarly, on July 11 the Presidents’ Alliance on Higher Education, which represents 180 colleges and universities, filed an amicus brief in the case. The amicus brief points out that the administration’s announced policy undermines universities’ reliance on previous assurances by Immigration and Customs Enforcement that foreign students could attend class remotely for the duration of the COVID-19 emergency and maintain their visas. Universities spent significant time and money preparing for the fall with that assurance in mind. Similarly, foreign students relied on the earlier assurances.³³ Even if the section 501(c)(3) limitation on political activity applied to non-legislative lobbying, the brief would meet the IRS’s methodology test; it lays out undistorted facts, is not inflammatory, and bases its conclusions on the facts presented.

Public Policy and Targeting

Three other legal considerations further undermine the president’s position in his tweet. First is the public policy doctrine. In *Bob Jones University*,³⁴ the Supreme Court held that a racially discriminatory school could not be tax exempt under section 501(c)(3) because racial discrimination in education “violates a most fundamental public policy.”³⁵ In support of that conclusion, the Court cited case law, legislation, and consistent support by the executive branch.

Nowhere, however, did the Court lay out what causes a policy to rise to the level of “a most fundamental public policy” in other contexts.

Although the Court did not explain when exactly public policy becomes most fundamental, it did at least provide hints for why racial discrimination in education violated a fundamental public policy.³⁶ Over the previous two and a half decades, the opinion observed, “every pronouncement of this Court and myriad Acts of Congress and Executive Orders attest a firm national policy to prohibit racial segregation and discrimination in public education.”³⁷

It may not require 25 years of consistency between the executive, legislative, and judicial branches to elevate a public policy to the level of most fundamental, but at the very least it must require more than a new position taken by one administration and subject to change by another. Opposition to such a new and controversial policy as the administration’s policy that foreign students must take at least one in-person class does not prevent tax exemption under the public policy doctrine.

The second consideration is a provision added to the IRC in 1998. Congress had become concerned about taxpayers’ perception that presidential influence on tax enforcement could have “a negative influence on taxpayers’ views of the tax system.”³⁸ To burnish taxpayer morale, Congress added section 7217, which forbids any federal official from telling the IRS to audit or otherwise investigate any taxpayer, whether the request is direct or indirect.³⁹ The president’s tweets potentially violated this prohibition. House Ways and Means Committee Chair Richard E. Neal, D-Mass., has called on both the Treasury Inspector General for Tax Administration and the Treasury Office of the Inspector General to investigate the IRS’s response to the Trump tweets. Treasury Secretary Mnuchin confirmed that he anticipates that

³¹ Eric Franklin Amarante, “Why Don’t Some White Supremacist Groups Pay Taxes?” 67 *Emory L.J. Online* 2045, 2053 (2018).

³² Complaint for Declaratory and Injunctive Relief, *President and Fellows of Harvard College v. U.S. Department of Homeland Security*, No. 1:20-cv-11283 (D. Mass. July 8, 2020).

³³ Brief for the Presidents’ Alliance on Higher Education as Amicus Curiae Supporting Petitioners at 1, *President and Fellows of Harvard College v. U.S. Department of Homeland Security*, No. 1:20-cv-11283 (D. Mass. July 11, 2020). Although neither of us participated in the preparation of the amicus brief, the Presidents’ Alliance on Higher Education represents both of our universities.

³⁴ *Bob Jones University v. United States*, 461 U.S. 574 (1983).

³⁵ *Id.*

³⁶ See Brunson and David J. Herzig, “A Diachronic Approach to Bob Jones: Religious Tax Exemptions after *Obergefell*,” 92 *Ind. L.J.* 1175, 1189 (2017).

³⁷ *Bob Jones University*, 461 U.S. at 593.

³⁸ Joint Committee on Taxation, “General Explanation of Tax Legislation Enacted in 1998,” JCS-6-98, at 44 (Nov. 24, 1998).

³⁹ Section 7217(a).

Treasury will conduct a “policy review” of universities related to the president’s tweet.⁴⁰

The third consideration involves legislation that is not included in the IRC. Congress has enacted legislation that prevents the IRS from targeting individuals and organizations for ideological reasons. After the controversy around the IRS’s treatment of Tea Party groups in 2013,⁴¹ Congress included a provision in the Consolidated Appropriations Act of 2018 prohibiting the IRS from using appropriated funds “to target groups for regulatory scrutiny based on their ideological beliefs.”⁴² The appropriations act for 2020 includes the same language.⁴³

Although this prohibition on targeting for ideological beliefs could theoretically come up against the public policy doctrine — an entity might espouse an ideological belief contrary to fundamental public policy — that possibility does not arise here. The position of the Trump administration regarding visas for foreign students does not amount to fundamental public policy, and thus opposition to it does not violate the public policy doctrine. The president’s tweet, however, asks Treasury to target universities based on their ideological beliefs. It is the president, not the university community, that seeks to violate applicable law.

In sum, the efforts by universities to oppose the recently announced visa rules for foreign students do not violate the lobbying limitations of section 501(c)(3), do not put into question their educational purpose, and do not violate public policy. Instead, it is the president who endorses a violation of the law when he asks federal tax administrators to examine colleges and universities on the basis of the schools’ principles and beliefs. ■

⁴⁰ Naomi Jagoda, “Treasury to Conduct Policy Review of Tax-Exempt Status for Universities After Trump Tweets,” *The Hill*, July 31, 2020.

⁴¹ Leandra Lederman, “IRS Reform: Politics as Usual?” 7 *Colum. J. Tax L.* 36, 42-43 (2016).

⁴² P.L. 115-141, section 108.

⁴³ Consolidated Appropriations Act, 2020, P.L. 116-93, section 107.

taxnotes®

Federal | State | International



Weekly Updates With Tax Notes Geo.

Choose any U.S. state
or country and receive
a full year of tax news
for just \$100.

Whether your focus area is New England
or England, Tax Notes Geo helps you stay
on top of important developments in the
tax world so you don't miss a thing.

taxnotes.com/country
taxnotes.com/state

News where
it matters most.