B. THE CONCEPT OF CHARITY

The Internal Revenue Code section 501(c)(3) provides that an organization organized and operated for "charitable" purposes may qualify for exemption from federal income tax. The concept of what is charitable has varied, however, with the time, the place and the needs of a particular community. The concept of what is charitable is still evolving today. In this topic we will examine the historical sources of charitability, describe what has been and is charitable under the regulations, state the current Service concepts of charity as derived from revenue rulings and finally look at a variety of theories under which charity law continues to evolve.

1. Early History of Charity in the U.S.

Although the origins of the concept of charity go back to antiquity, the modern American legal concept of charity is derived principally from the Elizabethan Statute of Charitable Uses. The preamble of the Statute provides that some funds should be set aside for the following charities:

> Statute of Charitable Uses, 1601, 43 Eliz. 1, C4.
>
> * * * for relief of aged, impotent and poor people, some for maintenance of sick and maimed soldiers and mariners, schools of learning, free schools and scholars in universities, some for repair of bridges, ports, havens, causeways, churches, sea-banks, and highways, some for education and preferment of orphans, some for marriages of poor maids, some for supportation, aid and help of young tradesmen, handicraftsmen, and persons decayed; and others for relief or redemption of prisoners or captives, and for aid or ease of any poor inhabitants * * *.

Since the establishment of the first non-wartime federal income tax in the United States in 1894 exemption has been provided to charitable organizations. Although the Act of August 27, 1894, section 32; 28 Stat. 509 was held unconstitutional by the Supreme Court in Pollock v. Farmers' Loan & Trust Co., 158 U.S. 601 (1895), the language of the exemption was only slightly changed in the Corporation Excise Tax Act of 1909, which provided that the excise tax should not apply

> * * * to any corporation or association organized and operated exclusively for religious, educational, or charitable purposes, no part of the net income of which inures to the benefit of any private shareholder or individual. * * *

Prior to the Act of 1894 the question of what to exempt did not arise except by virtue of statutory omission since in tax acts prior to that date the acts had specified the entities to be taxed. Three basic considerations underlay tax exemption, then and now:

1) "tradition", that is, the fact that historically certain types of organizations were not taxed and the legislators were not setting a precedent by continuing the exemption, 2) "morality", that is, that Congress was generally willing to exempt the income of organizations formed for the mutual benefit of members so long as they were primarily financed by such members, and 3) special interest legislation. See: McGovern, The Exemption Provisions of Subchapter F, 29 Tax Lawyer 523 (1976).

Following approval of the sixteenth amendment (ratified February 3, 1913), which permitted the levy of a federal income tax on persons and effectively overruled the Supreme Court decision rendered in 1895 holding the federal income tax to be unconstitutional, the Tariff Act of 1913 was passed.

That Act includes the same exemption provision as the Corporation Excise Tax Act of 1909 cited earlier, except for the addition of the word "scientific" and the reordering in sequence of the exempt purposes. Act of October 3, 1913, Ch. 16, section IIG.(a), 38 Stat. 114, 172.

So far as the term "charitable" is concerned, there has been no extensive change through a series of revenue acts from the Tariff Act of 1913 to the present IRC 501(c)(3), although additional privileges, requirements, and categories have been added. For example, those organizations within what is now IRC 501(c)(3) were given the privilege, in addition to exemption, of allowance of a deduction for individual contributions by the Revenue Act of 1917, section 1201(2), 40 Stat. 300, 330. In 1934, a limitation on political activities was added (later expanded in 1954, 68 Stat. 1, 163, to an outright prohibition on campaigning on behalf of any candidate for public office). In 1935, the contribution deduction was extended to corporations subject to a percentage of income limitation. Revenue Act of 1935, section 102(r), 49 Stat. 1014, 1016. In 1938, charitable contributions by individuals

were limited to domestic charitable organizations. Revenue Act of 1938, section 23(c), 52 Stat. 447, 463.

On numerous occasions courts and other authorities have expressed the view that the term "charity" cannot be restricted or confined. Some particularly well-stated comments include:

> * * * the enforcement of charitable uses cannot be limited to any narrow and stated formula. It must expand with the advancement of civilization and the increasing needs of man. New discoveries of science, new fields and opportunities for human action, the differing condition, character and wants of communities change and enlarge the scope of charity. *** Todd v. Citizens Gas Company of Indiana, 46 F. 2d 855, 865 (7th Cir. 1931) cert. den. 283 U.S. 852.

> * * * an inflexible construction fails to recognize the changing economic, social and technological precepts and values of contemporary society. *** Eastern Kentucky Welfare Rights Organization v. Simon, 506 F. 2d 1278, 1288 (D.C. Cir. 1974).

The rationale behind the granting of exemption from tax to private entities has been and continues to be based on the theory of shared social responsibility. The government and its citizens jointly share the responsibility for the well-being of the entire nation. Early governmental authorities granted tax exemption because they were either unable or unwilling to satisfy obvious social needs. Later, exemption was extended or continued for organizations whose purposes and activities were socially desirable. Today, of course, government conducts many of the activities previously done only by private philantrophy. Even today some needs can be better met by private philantrophy. The present system for tax exemption reflects this philosophy. This dual system of public and private philantrophy seems likely to persist well into the indefinite future.

2. Charity under the Regulations

The Concept of Charity under the Internal Revenue Regulations has slowly evolved and expanded. This evolution can be seen from the changes in the regulations over a number of years. Early Treasury regulations provided that:

> Corporations organized and operated exclusively for charitable purposes comprise, in general, organizations for the relief of the poor.

> The fact that a corporation established for the relief of indigent persons may receive voluntary contributions from the persons intended to be relieved will not necessarily deprive it of exemption. Treas. Reg. 118, section 39.101(6)-(b) (1943).

These regulations remained in force and unchanged through the years until 1956, when the Service issued proposed regulations stating:

> Organizations formed and operated exclusively for charitable purposes include, generally, organizations for the relief of poverty, distress, or other conditions of similar public concern. The fact that a charitable organization established for the relief of indigent persons may receive voluntary contributions from persons intended to be relieved, or that a hospital may require payments for services from those able to pay, will not necessarily preclude exemption. Treas. Reg. section 1.501(c)(3)-1(b), 21 F.R. 460, 463-464.

The regulations proposed in 1956 were withdrawn. Following an extensive study by the Service, the following regulations were issued in 1959:

> Treas. Reg. section 1.501(c)(3)-1(d)(2)
>
> * * * The term "charitable" is used in section 501(c)(3) in its generally accepted legal sense and is, therefore, not to be construed as limited by the separate enumeration in section 501(c)(3) of other tax-exempt purposes which may fall within the broad outlines of "charity" as developed by judicial decisions. Such term includes: Relief of the poor and distressed or of the underprivileged; advancement of religion; advancement of education or science; erection or maintenance of public buildings, monuments, or works; lessening of the burdens of government; and promotion of social welfare by organization designed to accomplish any of the above purposes, or (i) to lessen neighborhood tensions; (ii) to eliminate prejudice and discrimination; (iii) to defend human and civil rights secured by law; or (iv) to combat community deterioration and juvenile delinquency. ***

These major delineations of charity set forth in the regulations remain in effect today. This regulation section is quite plastic, however. In each category there have been expansions beyond the original meaning of the term at the time the

regulations were enacted. As will be seen in the next section, each of the areas has expanded or changed as a result of court decisions, new types of organizations, and newly recognized charitable needs and classes.

3. Changing Service Concepts of Charity

Nothing is more constant than change and change in the Service's concept of what is charity is no exception. An examination of each of the categorizations of charity under the regulations indicates something of the nature of the evolution of the Service's concept of charity.

a. Charitable as Used in its Generally Accepted Legal Sense

Since the term "charitable" is used in IRC 501(c)(3) in its generally accepted legal sense, the Service has occasionally used the word "charitable" standing alone as a basis for exemption.

This approach first appeared in 1968 when the Service ruled that an organization that ministers to the nonmedical needs of patients in a proprietary hospital may qualify for exemption. Nonmedical needs include reading to patients, writing letters for them, and providing similar personal services, and are designed to improve the patients' mental well-being and physical comfort. Rev. Rul. 68-73, 1968-1 C.B. 251.

Later, in 1969, an organization that provided emergency rescue services to (1) stranded, lost or injured persons, and (2) persons suffering because of fire, flood, accident, or other disaster was ruled to qualify for exemption. This organization was viewed as serving a charitable purpose in the legal sense by protecting the health, safety, and life of persons. Rev. Rul. 69-174, 1969-1 C.B. 149.

Following an absence of this approach for 8 years, two consecutive rulings reflecting it were published. One ruling exempted an organization which provides a color guard and conducts flag-raising and other ceremonies at patriotic and community functions. In the other ruling the Service considered whether an organization that maintained a public park in a heavily trafficked and built up part of the city could qualify for exemption. The Service concluded that by planting trees, flowers, and shrubs, by maintaining the facilities in the park, and mowing the grass and picking up the litter, the organization was insuring the continued use of

the park for public recreational purposes. Rev. Ruls. 78-84 and 78-85, 1978-1 C.B. 150.

It is not clear whether this approach will continue to be used by the Service, given the paucity of instances in which the rationale has been applied. However, its use is likely where there is agreement that the activity is charitable but disagreement as to whether the activity can be fit into any of the more explicit definitions of the term charitable.

b. Relief of the Poor and Distressed or of the Underprivileged

The relief of the poor or those in similar distress is one of the four oldest recognized forms of charitable purposes. The Service cites the phrases "relief of the poor" and "relief of the poor and distressed or relief of the underprivileged" in a number of revenue rulings.

In an early series of cases the Service took the position that a charitable bequest must be limited to charity, that is, to the poor as a class. These cases arose either as direct questions of exemption from Federal income tax or of the deductibility of charitable contributions by individuals or estates.

In Young Men's Christian Associations Retirement Fund, Inc. v. Commissioner, 18 B.T.A. 139 (1929); acq. IV-1 C.B. 160, the Service argued that an organization failed to qualify for exemption if it limited the beneficiaries of charity to a particular group or class. The court concluded, "We do not think that the mere restriction of the beneficiaries of an otherwise charitable corporation to a designated group or class is sufficient upon which to deny exempt classification. ***"

In Markle v. Commissioner, 28 B.T.A. 201 (1933), the gift out of the estate's property to a hospital to build a wing in the memory of the deceased's mother was disallowed by the service because it was not limited to charity. Similarly, in Estate of Carolyn E. Gray v. Commissioner, 2 T.C. 97 (1943), the testator had willed her residuary estate to an exempt hospital to create a special fund, " * * * to provide special nurses and special nursing care for nurses who are graduates of a recognized school of nursing and are patients of said hospital. * * *" The executor of the estate deducted the charitable remainder interest under the predecessor of IRC 2055(a), but the Service disallowed the entire deduction and insisted a deficiency existed.

At least two revenue rulings adopted this approach. In Rev. Rul. 56-185, 1956-1 C.B. 202, the Service ruled that a hospital may qualify for exemption only if it was operated to the extent of its financial ability for those unable to pay for the Services rendered. In Rev. Rul. 57-467, 1957-2 C.B. 313 (later superseded), the Service ruled that an organization operating a home for aged people that does not accept charity guests and that requires the discharge of guests who fail to make certain required monthly payments is not organized and operated exclusively for charitable purposes and cannot therefore qualify for exemption under IRC 501(c)(3).

This position was in direct conflict with courts and commentators. While the decision in Markle failed to indicate the basis for the Service's approach, the court found the bequest to be for a charitable purpose. This decision also had the effect of stating that the promotion of health is a charitable purpose. In Estate of Carolyn E. Gray, supra, the court found that the Service's

> * * * real objection to the allowance of the bequests as charitable bequests is that any graduate nurse, regardless of her ability to pay for such services, may receive the benefits ensuing from the bequests. Respondent, therefore, concludes that the purpose of the trust is not an "exclusively charitable" purpose.

The court then reviewed several previous court cases and concluded that

> * * * if the class which is to receive the benefits is not so small that the community does not benefit from the aid given to them and if the aid to be given relates to the relief of the sick or aged, etc., the gift does not lose its character as a gift for a charitable purpose merely because all the recipients do not have to be paupers.

Another court found that

> * * * Relief of poverty is not a condition of charitable assistance. If the benefit conferred has a sufficiently widespread social value, a charitable purpose exists. In Re Henderson's Estate, 112 P. 2d 605, 607 (Cal. 1941).

The Service has not singled out any particular class or group of persons as automatically being poor and distressed or as being underprivileged. It has found, however, since the publication of the current regulations, certain activities

conducted for, on behalf of, or to benefit identifiable classes of people may qualify as charitable activities. These classes and the related activities include:

(1) The elderly --

A. Homes for the aged, Rev. Ruls. 61-72, 1961-1 C.B. 188; 64-231, 1964-2 C.B. 139; and 72-124, 1972-1 C.B. 145.

B. Employment placement, Rev. Rul. 66-257, 1966-2 C.B. 212.

C. A senior citizens center, Rev. Rul. 75-198, 1975-1 C.B. 157.

D. A rural test home, Rev. Rul. 75-385, 1975-2 C.B. 205.

E. Meals for homebound, Rev. Rul. 76-244, 1976-1 C.B. 155.

F. Closed circuit radio broadcasting, Rev. Rul. 77-42, 1977-1 C.B. 142.

G. Low cost transportation in unserved areas, Rev. Rul. 77-246, 1977-2 C.B. 190.

H. Specially constructed housing for the elderly, Rev. Rul. 79-18, 1979-1 C.B. 194.

(2) The needy-artists, musicians, composers, writers, and scholars otherwise financially unable to complete their projects, Rev. Rul. 66-103, 1966-1 C.B. 134, and women needing to market their cooking and needlework, Rev. Rul. 68-167, 1968-1 C.B. 255.

(3) The handicapped--meals for homebound, Rev. Rul. 76-244, supra, and low cost transportation in unserved areas, Rev. Rul. 77-246, supra. Specially constructed housing for the handicapped, Rev. Rul. 79-19, 1979-1 C.B. 195.

(4) Low income individuals --

A. Families--housing needs, Rev. Rul. 67-138, 1967-1 C.B. 129, and financial counseling and related budget services, Rev. Rul. 69-441, 1969-1 C.B. 115.

B. Homeowners--interest-free home repair loans in badly deteriorated areas, Rev. Rul. 76-408, 1976-2 C.B. 145.

C. Individuals--financial counseling and related budget services, Rev. Rul. 69-441, supra.

D. Residents--free legal services to such residents in economically depressed communities, Rev. Rul. 72-559, 1972-2 C.B. 247.

A. E. Unemployed and underemployed nonskilled persons needing educational and vocational training, Rev. Rul. 73-128, 1973-1 C.B. 222.

E. Organizations of public housing tenant groups, Rev. Rul. 75-783, 1975-2 C.B. 201.

(5) The indigent -- free legal services, Rev. Rul. 69-161, 1969-1 C.B. 149, and free blood when hospitalized, Rev. Rul. 66-323, 1966-2 C.B. 216.

(6) Persons accused of crime, if unable to raise bail, Rev. Rul. 76-21, 1976-1 C.B. 147, or pay bondsmen's fees, Rev. Rul. 76-22, 1976-1 C.B. 148.

(7) The foreign poor--rural inhabitants of developing countries, Rev. Rul. 68-117, 1968-1 C.B. 251, and the underprivileged in Latin America. Rev. Rul. 68-165, 1968-1 C.B. 253.

A common characteristic running through the above seven classes is the element of poverty, which tends to reflect the Service's traditional approach. However, the Service has expanded this position to include exempt organizations that benefit a particular class which is not generally considered to be poor. For example, in Rev. Rul. 69-257, 1969-1 C.B. 151, the Service recognized as exempt an organization that awards scholarships to students strictly on the basis of scholastic ability without regard to financial need. The Service found that "a trust for educational purposes is charitable although the persons to be educated are not limited to the poor." This ruling effectively expanded an earlier revenue ruling which ruled that an organization that provided worthy and needy students with housing and with financial assistance (gifts, grants, scholarships, no-interest loans, etc.) to enable them to attend a college or university may qualify for exemption. Rev. Rul. 64-274, 1964-2 C.B. 141.

Subsequently, the Service ruled that an organization could benefit employed factory workers by providing a work-related child care and development center for their preschool age children. Rev. Rul. 70-533, 1970-2 C.B. 112. In this instance children were selected on the basis of financial need of the family. In addition, the organization took in children recommended by the local antipoverty and welfare agencies.

The term "distressed" generally is not equated with "poor." The former term is used in revenue rulings dealing with emergency situations and with the elderly. A volunteer fire company whose primary activity is fire fighting and rescue work may qualify for exemption as its services relieve the distressed. Rev. Rul. 74-361, 1974-2 C.B. 159. Such an organization must itself be directly engaged in charitable activities and not be operated in a manner similar to organizations operated for a profit. Such was the rationale for denying exemption to an organization that rents housing and performs related services at cost to a city for use as free temporary housing shelter for families whose homes have burned. Rev. Rul. 77-3, 1977-1 C.B. 141.

With respect to the elderly as a distressed class, two early revenue rulings found that an organization that operated a home for the aged could qualify for exemption if it met certain additional requirements. Rev. Ruls. 61-72, 1961-1 C.B. 188, and 64-231, 1964-2 C.B. 139.

In Rev. Rul. 72-124, supra, the Service set forth several requirements, as alternatives to those found in the two earlier rulings, for a home for the aged to qualify as an exempt organization. In this ruling the Service stated that providing for the special needs of the elderly has long been recognized as a charitable purpose when the elements of relief of distress and community benefit have been found to be present.

While this ruling does not classify the aged as a charitable class per se, it does recognize that the elderly, apart from financial distress, have special needs, including housing, health care, and financial security because of their advanced years. This recognition of the special needs and circumstances of the elderly may be due to the awareness of the conditions of life of older people in American society," * * * augmented by the increasing number and proportion of the aged in the population and their consequent greater visibility to the rest of society. In 1850 about 3 percent of the population was aged 65 and over; 100 years later, it was 8 percent; and in 1975 persons aged 65 and over constituted 10 percent of the population..." Youmans, The Rural Aged, 429 Annals of the American Academy

of Politics and Social Science 81, 82 (January 1977). This awareness has been exemplified in the numerous revenue rulings governing activities benefitting the elderly.

No revenue ruling cites relief of the underprivileged by itself when describing whether or not a particular organization qualifies for exemption. Rather, the phrase "relief of the poor and distressed or relief of the underprivileged" is used entirely or merely the phrase "relief of the poor and distressed." In only one revenue ruling has the Service nearly described a particular class or group as definitely underprivileged. In that ruling, an organization had been formed in the United States to work directly with village groups, jungle colonies, and other groups in a Latin American country to assist underprivileged people in improving their living conditions through educational and self-help programs. Rev. Rul. 68-165, 1968-1 C.B. 253. The organization's activities included furnishing tools, educational materials, and other supplies; it was primarily educational in nature. The Service concluded that furnishing tools and material to help improve living conditions of the underprivileged is charitable within the meaning of IRC 501(c)(3).

While the Service early recognized relief of the poor as a charitable purpose, at no time has it identified one or more classes or groups as automatically poor, distressed, or underprivileged so that any activity conducted for such a class by a nonprofit organization will enable the organization to secure exemption from Federal income tax. Rather, the Service has expanded that concept to include activities that benefit persons of low-income (monetary approach) and the elderly (sociological approach) on the basis of circumstances or special needs of the particular class. The Service does not use relief of the underprivileged as a separate reason for finding any organization exempt under IRC 501(c)(3).

c. Advancement of Religion, Education, or Science

IRC 501(c)(3) includes descriptive words in addition to the word "charitable." If the word "charitable" had been used alone, then the popular meaning of the word would have limited its applicability to only organizations which relieve the poor. However, Congress appears to have wanted to extend the concept of "charitable" to include other purposes and activities, as many States do, and not to limit the term merely to relief of the poor.

The terms "educational and scientific" are separately defined in their own regulations sections, 1.501(c)(3)-1(d)(3) and 1.501(c)(3)-1(d)(5) respectively. The

regulations sections provide fairly good definitions of what is meant by the terms. The term "advancement" is not defined. Arguably, advancement of education or advancement of science goes beyond being merely educational or scientific. Advancement in terms of being charity can be construed as a more liberal charitable standard, where admittedly educational or scientific activities are present.

Advancement of religion is also a very liberal standard in terms of charity. What is religion is, of course, a problem upon which the regulations and revenue rulings given almost no guidance. In addition to this liberal standard, the Service and the courts have been reluctant to examine religion too deeply because of First Amendment considerations. This suggests that organizations desirous of qualifying as religious or advancing religion can qualify for exemption if the religion in question fits within the common understanding of the term. See 1978, 1979, and 1980 EOATRI topics on Churches and Religion.

d. Erection or Maintenance of Public Buildings, Monuments, or Parks

This phrase first appeared in the regulations in 1959 and since that time has been used sparingly in revenue rulings. The Service has always used the phrase ("erection or maintenance ...") in conjunction with the phrase "lessening of the burdens of government." For example, the Service ruled that an exempt organization that created and maintained a public park would not have its exempt status jeopardized if it accepted donated land from the corporation that formed and controlled it and used a picture of the park as its brand symbol. The Service stated:

> * * * Establishing and maintaining a public park is an activity similar to erection or maintenance of public buildings, monuments or works, lessening the burdens of government and the promotion of social welfare for any of those purposes. Rev. Rul. 66-359, 1966-2 C.B. 218.

Later, the Service supported this community-wide benefit theory in the case of an organization formed to preserve and improve a lake used as a public recreational facility. Rev. Rul. 70-186, 1970-1 C.B. 129. The maintenance and improvement of public recreational facilities appears to be generally accepted as a charitable purpose if the other requirements of IRC 501(c)(3) and the regulations are met. Rev. Rul. 67-325, 1967-2 C.B. 113. For example, the Service ruled that an organization that provides funds to a city transit authority to insure that bus service for the city is continued by the proprietary bus company until the city can take over its operation may qualify for exemption because it is assisting the municipal

government and conferring a benefit upon the entire community. Rev. Rul. 71-29, 1971-1 C.B. 150.

There is no published definition of "public building, monument or work." It is reasonable to apply the doctrine of noscitur a sociis (that is, to qualify as a charitable organization performing this purpose, the subject of the organization's activity must possess the general characteristics of a public building, etc.) In one case a court found that an organization that met the requirements of IRC 501-504 (before the Tax Reform Act of 1969), and which had a reasonable objective in accumulating substantial funds to construct a civic building for a county, qualified for exemption under the predecessor to IRC 501(c)(3). Hulman Foundation v. U.S., 217 F. Supp. 423 (S.D. Ind. 1962).

That this phrase has always been cited in conjunction with the phrase "lessening of the burdens of government" indicates, at the minimum, that the Service has been reluctant to use the phrase as an independent means for justifying exemption or that these two phrases are, in effect, inseparable of government structures or of public works such as lakes or waterways. This latter concept may be due to the fact that in each phrase different words, "public" and "government" are used to indicate benefits for the community at large.

Because of the absence of this phrase in court cases generally and as an independent basis for exemption in revenue rulings, it is unlikely that the "erection or maintenance of public buildings, monuments or works" will ever become an independent basis for exemption for a large number of organizations.

e. Lessening the Burdens of Government

The phrase "lessening of the burdens of government" (hereafter, "burdens") was not included in the regulations until 1959. It is only since that time that the Service has cited that phrase in revenue rulings. The Service has taken several approaches in applying this phrase to organizations seeking exemption. In the first approach, the Service cites the "burdens" phrase and either makes no further reference to it or simply concludes that the activity involved lessens the burdens of government. Rev. Ruls. 59-310, 1959-2 C.B. 146; 65-2, 1965-1 C.B. 227; 66-257, 1966-2 C.B. 212; 66-358, 1966-2 C.B. 218; 67-138, 1967-1 C.B. 129; 68-17, 1968-1 C.B. 247; 70-583, 1970-2 C.B. 114.

The second approach focuses on whether there are direct or implied cost or work force savings to the Government that are attributable to the activities of the

organization. In 1962 the Service ruled that an exempt organization that distributes its income to a State or municipality or to an activity that is an integral part thereof does not jeopardize its exempt status under IRC 501(c)(3) provided that the funds are used to carry out the purposes which constitute the basis of the donor organization's exemption. Rev. Rul. 62-78, 1962-1 C.B. 186. See also Rev. Ruls. 68-14, 1968-1 C.B. 243 (city beautification); 70-583, 1970-2 C.B. 114 (rehabilitation program for released prisoners); and 70-584, 1970-2 C.B. 114 (student internships in government) which demonstrate this approach.

The third approach is assistance in the performance of governmental functions. The Service ruled in 1974 that an organization that assists the police department in the apprehension and conviction of criminals by making funds available for rewards qualifies for exemption under IRC 501(c)(3) because "the gratuitous performance of services to Federal, state or local governments is charitable in the generally accepted legal sense," and such activity lessens the burdens of government. Rev. Rul. 74-246, 1974-1 C.B. 130. See also: Rev. Ruls. 71-29, 1971-1 C.B. 150 and 77-99, 1971-1 C.B. 151 which reflect this approach by implication.

Consistent with the governmental functions approach is the concept that if benefits derived flow principally to the general public or if the organization's purposes are beneficial to the community as a whole, the activity will be considered charitable. For example, the Service has ruled that an organization formed to preserve and improve a lake used extensively as a public recreational facility qualifies for exemption under IRC 501(c)(3). The rationale for this conclusion is that such action insures the continued use of the lake for public recreational purposes and constitutes a charitable activity, and "the benefits to be derived from the organization's activities flow principally to the general public" through the maintenance and improvement of public recreational facilities. Rev. Rul. 70-186, 1970-1 C.B. 129. The Service has also noted that traffic control and safety are universally recognized as a governmental responsibility and that an organization which provides expert opinions to local government officials regarding the existence of hazardous traffic conditions in their communities is lessening the burdens of government and thus is engaged in a charitable activity. Rev. Rul. 76-418, 1976-2 C.B. 145. See also: Rev. Rul. 78-68, 1978-1 C.B. 149 (provision of bus transportation in isolated communities). In the approaches based on cost or work force savings and government functions, the Service has taken the position that the activity itself must be charitable before the Service will recognize the activity as also lessening the burdens of government. Rev. Ruls. 62-78 and 76-418, supra.

The fourth, and most current approach, the governmental designation approach, is to determine whether the activity conducted is a governmental activity or function. Initially, the Service considered what independent legal authorities have determined to be governmental functions. In four different revenue rulings the Service cited three different bases for this approach: The Statute of Charitable Uses, Rev. Rul. 71-29, 1971-1 C.B. 150; the work of commentators (twice), Rev. Ruls. 75-385, 1975-2 C.B. 204 and 71-99, 1971-1 C.B. 151; and State court cases, Rev. Rul. 74-361, 1974-2 C.B. 159. At the same time, in Rev. Rul. 74-117, 1974-1 C.B. 128, the Service expressed the view that the government is the party best qualified to decide whether a particular activity is sufficiently in the public interest to warrant its recognition as a legitimate function of government.

Because of the wide range of activities undertaken by various governments, exemption under IRC 501(c)(3) because an organization lessens the burdens of government may grow to accumulate the widest variety of exempt purposes that are charitable but do not fit easily into any of the other charitable purposes described in Reg. 1.501(c)(3)-1(d)(2). The governmental designation" approach may, however, require other charitable purposes to justify exemption.

f. Promotion of Social Welfare

Prior to 1959, promotion of social welfare was not defined as charitable. The 1959 regulations officially recognize for the first time that promotion of social welfare may constitute a charitable activity. The reason why this phrase was included in the regulations is difficult to ascertain. It may have resulted from the general recognition that the term "charitable" is not to be limited to the purposes enumerated in IRC 501(c)(3), but may be influenced by judicial decisions, as we saw in our discussion concerning relief of the poor, etc. This term may have been an outgrowth of the discussion surrounding the Treasury Regulations governing private interest versus public benefit. Finally, this phrase may have been adopted because it represented a more definitive and restricted way of stating the community benefit theory of Rev. Rul. 69-545, 1969-2 C.B. 117.

The types of activities which have been found to be charitable as the promotion of social welfare have been many and varied. From Reg. 1.501(c)(3)-1(d)(2), one can see several combinations of the term "social welfare" are possible. First, it may be used without reference to any of the purposes enumerated above it (relief of the poor and distressed or relief of the underprivileged; advancement of religion; advancement of education or science; erection or maintenance of public

buildings, monuments, or works; or lessening of the burdens of government) or subparts listed below it (lessening neighborhood tension; elimination of prejudice and discrimination; promotion of human and civil rights; and combatting community deterioration and juvenile delinquency). Second, it may be used in conjunction with any of its subparts. The following list of revenue rulings indicates some of the various combinations used in finding an organization's activity charitable as promotion of social welfare:

(1) lessening neighborhood tensions

(2) eliminating prejudice and discrimination

(3) defense of human and civil rights secured by law

(4a) combatting community deterioration

(4b) combatting juvenile delinquency

Rev. Rul. 65-2, 1965-1 C.B. 227 (4b)
(teaching a specific sport to children)

Rev. Rul. 67-138, 1967-1 C.B. 129 (4a)
(providing assistance to low-income families to obtain improved housing)

Rev. Rul. 67-250, 1967-2 C.B. 182 (1, 2, 3, 4a, 4b)
(education of public on need for housing available on a nondiscriminatory basis)

Rev. Rul. 67-391, 1967-2 C.B. 190 (4a)
(development of community land use plan)

Rev. Rul. 68-14, 1968-1 C.B. 243 (4a)
(assisting city tree planting and beautification projects)

Rev. Rul. 68-15, 1968-1 C.B. 244 (1, 2, 4a, 4b)
(investigation and education of public on social problems)

Rev. Rul. 68-17, 1968-1 C.B. 247 (4a, 4b)
(demonstration housing project for low-income families)

Rev. Rul. 68-70, 1968-1 C.B. 248 (2)
(advancing equal job opportunities)

Rev. Rul. 68-438, 1968-2 C.B. 209 (1, 2, 3)
(promoting lessing of racial and religious prejudice in the fields of housing and public accomodations)

Rev. Rul. 68-655, 1968-2 C.B. 213 (1, 2, 4a, 4b)
(promoting racial integration in neighborhoods)

Rev. Rul. 70-79, 1970-1 C.B. 127 (4a)
(conducting planning research for a metropolitan area)

Rev. Rul. 70-585, 1970-2 C.B. 115, Situation 2 (1, 2, 4a, 4b)
(ameliorating housing needs of minorities by building new housing for low-income persons)

Rev. Rul. 72-228, 1972-1 C.B. 148 (2)
(promotion of equal job rights for women)

Rev. Rul. 72-560, 1972-2 C.B. 248 (4a)
(establishment of recycling center)

Rev. Rul. 74-587, 1974-2 C.B. 162 (1, 2, 4a, 4b)
(stimulating economic development in high density urban areas by low-income minority and disadvantaged groups by providing financial assistance to business to obtain funds not available through normal commercial sources)

Rev. Rul. 76-147, 1976-1 C.B. 151 (4a)
(preventing potential community deterioration)

Rev. Rul. 76-205, 1976-1 C.B. 154 (1)
(establishment of immigrant aid center)

Rev. Rul. 76-419, 1976-2 C.B. 146 (4a, 4b)
(purchasing blighted land in an economically depressed community)

With regard to the above listing several observations are in order. No revenue ruling published through 1977 cited promotion of social welfare alone as a

reason for exemption under IRC 501(c)(3). For a short time, from 1966 to 1968 and again in 1974, the Service exempted organizations conducting social welfare programs in conjunction with purposes enumerated in the regulations. Rev. Ruls. 66-257, 1966-2 C.B. 212; 66-358, 1966-2 C.B. 218; 68-165, 1968-1 C.B. 235; and 74-117, 1974-1 C.B. 128. However, in each instance, except in 1974, the ruling merely repeated the other enumerated charitable purpose, cited social welfare by itself, and concluded that the organization was engaged in a charitable activity.

In all other social welfare rulings issued through 1978 under IRC 501(c)(3) (except one, Rev. Rul. 76-147, supra), the rulings contain a prior enumerated charitable purpose as a basis for exemption as well. This result may reflect the Service's reluctance to find social welfare or any of its subparts as constituting a sole basis for exemption because this term is identical to, and confused with, but is not synonymous with the term used in IRC 501(c)(4).

Except for those revenue rulings published in 1966-68 and again in 1974 that merely cite the term "social welfare," all other social welfare rulings under IRC 501(c)(3) include one or more subparts of the term as a basis for finding exemption appropriate.

No revenue ruling has been published which finds that the lessening of neighborhood tensions and the defending of human and civil rights secured by law constitute an independent basis for exemption. These phrases are always used with other subparts of social welfare or with prior enumerated charitable purposes.

In Rev. Rul. 76-147, supra, the Service ruled that an organization that seeks to combat community deterioration need not be in a community that is presently deteriorated in order to qualify for exemption. In that ruling, the community consisted of an area where the median income level and quality of housing were generally higher than in many other parts of the city, but the activities described showed that the organization was benefitting the community in a charitable activity. This ruling modified Rev. Rul. 67-6, 1967-1 C.B. 135, in which an organization that preserved and maintained a historic or scenic area for the benefit and education of the public was held charitable, but preservation and maintenance for the benefit solely of the residents of the community rather than for the general public could not qualify for exemption under IRC 501(c)(3) but could qualify under IRC 501(c)(4). Rev. Rul. 76-147 is also significant as it is the only revenue ruling yet published that exempts an organization under a subpart of social welfare without combining exemption with any prior enumerated charitable purpose or with the term "social welfare."

The term "social welfare" is used both in IRC 501(c)(3) and IRC 501(c)(4). A social welfare organization exempt under IRC 501(c)(3) could qualify for exemption without more under IRC 501(c)(4), but not the reverse. The principal distinction between a charitable (social welfare) and social welfare organization is that the charitable organization is prohibited from carrying on propaganda or otherwise attempting to influence legislation as a substantial part of its activities. The IRC 501(c)(3) organization may not be an "action" organization. The IRC 501(c)(4) organization may be an action organization so long as it does not intervene in political campaigns as a primary activity, because political campaign activity per se is not an exempt IRC 501(c)(4) social welfare activity. Compare Reg. 1.501(c)(3)-1(c)(3)(v) with 1.501(c)(4)-1(a)(2)(ii).

In conclusion, it seems likely that the list of activities found to be the promotion of social welfare will continue to expand, in part to meet the needs for recognition of exemption for charitable endeavors not more easily categorized as traditional charitable activities.

g. Promotion of Health

Promotion of health has long been considered a charitable purpose as evidenced by the reference to "maintenance of sick and maimed soldiers and mariners. . ." in the Statute of Charitable Uses (1601).

Originally the Service based exemption of health care providers (hospitals and clinics) on the standard of "relief of the poor." See: Treas. Reg. 118, section 39.101(6)-1(b) (1943), also Rev. Rul. 56-185, 1956-1 C.B. 202. Rev. Rul. 56-185 reflected the traditional approach in that exemption was allowed only if the health care provider was "operated to the extent of its financial ability for those not able to pay for the services rendered and not exclusively for those who are able and expected to pay. . ."

The Service's standards for exemption for organizations promoting health underwent a series of changes between 1956 (the date of Rev. Rul. 56-185) and 1969 (the date of The Tax Reform Act of 1969 and the enactment of IRC 501(e)). This change was the result of a number of factors. First, the Service had conducted an extensive study concerning the definition of "charitable." The results were published in the 1959 regulations which supported the definition of "'charitable' as used in IRC 501(c)(3) in its generally accepted legal sense", and listed a number of types of activities that benefit the community. This expanded the prior regulations

which had a limited definition of "charitable." Secondly, Congress passed Medicare and Medicaid to provide Federal payment of medical bills incurred by the elderly and the poor, respectively. Third, it was generally recognized that third-party reimbursement for medical expenses was steadily covering more and more people. Fourth, Congress added a new subsection, IRC 501(e) in 1968, to the effect that an organization shall be treated as organized and operated exclusively for charitable purposes if: (1) it performs one or more enumerated services that it could perform on its own behalf if it was a hospital exempt under IRC 501(c)(3), and (2) it performs such service, for example, for two or more exempt hospitals.

In positioning itself for a major change to its approach in Rev. Rul. 56-185, the Service issued two rulings in 1968 and 1969 setting the stage for a major change. In the first the Service ruled that an organization that ministers to the nonmedical needs of patients in a proprietary hospital may qualify for exemption. These nonmedical needs include such things as reading to patients, writing letters for them, and providing similar personal services. These services were designed to improve the patients' medical well-being and physical comfort. Rev. Rul. 68-73, 1968-1 C.B. 251. Then, in early 1969, in Rev. Rul. 69-174, 1969-1 C.B. 149, it was ruled that an organization that provided emergency rescue services to (1) stranded, lost, or injured persons, and (2) persons suffering because of fire, flood, accident, or other disaster could qualify for exemption. In this ruling the Service found that the organization serves a charitable purpose by protecting the health, safety, and life of persons. It should be noted that neither ruling found the promotion of health to be a charitable purpose per se. Each, however, discusses obvious health activities that are undertaken by the respective organizations.

The Service finally recognized the promotion of health as an independent basis for exemption in 1969. In Rev. Rul. 69-545, 1969-2 C.B. 117, the Service modified the requirements of Rev. Rul. 56-185 by providing an alternative means for hospitals to obtain exemption. The Service stated that (1) by operating an emergency room open to everyone and (2) by providing hospital care for all persons in the community able to pay the cost either directly or through third-party reimbursement (that is, medical insurance), a hospital is promoting the health of a class of persons that is broad enough to benefit the community.

The publication of Rev. Rul. 69-545 sparked a number of health care related rulings in which the Service found the promotion of health to be a charitable purpose within the legal sense of the term "charitable." For example, organizations which operate the following types of activities and which meet all the other requirements of IRC 501(c)(3) may qualify for exemption:

Rev. Rul. 70-590, 1970-2 C.B. 16 --

A drug rescue and drug counseling service.

Rev. Rul. 72-16, 1972-1 C.B. 143 --

A residence facility and therapeutic group living program for recently released mental institution patients.

Rev. Rul. 72-124, 1972-1 C.B. 145 --

A home for the aged.

Rev. Rul. 72-209, 1972-1 C.B. 148 --

Home health care service primarily for the elderly.

Rev. Rul. 73-313, 1973-2 C.B. 174 --

A medical building and facilities to attract a doctor to provide medical services in a medically unserved community.

Rev. Rul. 75-197, 1975-1 C.B. 156 --

A free computerized donor-authorized body organ retrieval system for the benefit of donees.

Rev. Rul. 75-472, 1975-2 C.B. 208 --

A halfway house to provide room and board, therapy, and counseling for current and former alcoholics.

Rev. Rul. 77-68, 1977-1 C.B. 142 --

Individual psychological and educational evaluation as well as tutoring and therapy for children with learning disabilities.

Rev. Rul. 77-69, 1977-1 C.B. 143 --

> A health systems agency pursuant to the National Health Planning and Resources Development Act of 1974 (P.L. 93-941; 42 U.S.C. section 300k).

Rev. Rul. 78-427, 1978-2 C.B. 176 --

> A Christian Science medical care facility.

Rev. Rul. 79-17, 1979-1 C.B. 139 --

> Hospice for the terminally ill.

Rev. Rul. 79-358, 1979-45 I.R.B. 9 --

> Private hospital room to all who can medically benefit from it.

Recently, a trust created by an exempt IRC 501(c)(3) hospital forthe sole purpose of accumulating and holding funds to be used to satisfy malpractice claims against the hospital and from which the hospital directs the bank-trustee to make payments to claimants was ruled to be exempt. Rev. Rul. 78-41, 1978-1 C.B. 148. Exemption was granted because the trust is operating as an integral part of the hospital and is performing a function that the hospital could do directly.

Promotion of health will continue to be an independent basis for exemption for health care and health related organizations. Further, promotion of health will be expanded to cover wholly new areas. The health care field is ever expanding as larger and larger segments of our society seek more comprehensive health care. New and more complex health care entities will be created. That these entities will attempt to qualify for exemption as charitable may be taken as a given. The promotion of health rationale for exemption will therefore have to undergo continuing re-definition and growth. See 1979 and 1980 EOATRI topics on Health.

h. Environmental Action

The National Environmental Policy Act of 1969, P.L. 91-190, 42 U.S.C. 4321, 83 Stat. 852, expressed Congressional concern and National Policy on the protection of the environment. The purpose of the Act was to:

> * * * promote efforts which will prevent or eliminate damage to the environment and biosphere and stimulate the health and welfare of man. . . [and] enrich the understanding of the ecological systems and natural resources important to the Nation. . . .

Shortly thereafter the Service ruled in Rev. Rul. 72-560, 1972-2 C.B. 248, that an organization formed (1) to educate the public regarding environmental deterioration due to solid waste pollution and (2) to provide facilities for the collection of certain recyclable materials may qualify for exemption. The Service ruled that the recycling of waste materials, because it combats and helps prevent environmental deterioration, is analogous to the tree-planting and street-cleaning operations that were held to serve a charitable purpose in Rev. Rul. 68-14. Revenue Ruling 72-560, however, fails to note that the real basis for approval of exemption in Rev. Rul. 68-14 is that the planting and cleaning activities lessen the burdens of government. The Service concluded that the overall effect of these activities is to combat community deterioration. Thus, while the Service does not say in this ruling that protection of the environment is per se charitable, it implies that such may be the case through the analogy to Rev. Rul. 68-14.

In Rev. Rul. 76-204, 1976-1 C.B. 152, the Service ruled that an organization formed to preserve the natural environment by acquiring and maintaining ecologically significant undeveloped land such as swamps, marshes, forests, wilderness tracts, and other natural areas may qualify for exemption. The Service concluded that by acquiring and preserving ecologically significant undeveloped land, the organization is enhancing the accomplishment of express national policy and, in this sense, it is advancing education and science and benefitting the public in a manner that the law regards as charitable.

Revenue Ruling 76-204 cites two previous rulings that bear on the subject. In one the Service ruled that an organization formed to preserve a lake as a public recreational facility and to improve the condition of the water therein to enhance its recreational facilities qualified for exemption. Rev. Rul. 70-186, 1970-1 C.B. 128. Such action constitutes a charitable activity as the benefits to be derived therefrom flow principally to the general public. In the other cited ruling, Rev. Rul. 67-292, 1967-2 C.B. 184, the Service ruled that an organization that purchased and maintained a large tract of forest land to be used as a sanctuary for wild birds and animals and to be open to the public qualifies for exemption because it was educational. Here the Service stated that such an organization was similar to a museum or zoo.

Thus, exemption for organizations that protect and promote the preservation of the environment is based on grounds of charity in the legal sense or advancement of education and science, lessening the burdens of government, community development and National Policy.

It is not clear how much further this rationale for exemption will evolve, but given the nationwide public concern for the environment, there will probably be additional activity in the area. For background, see the 1979 EOATRI topic on Preservation.

i. Public Interest Law Firms

The provision of legal services generally is viewed as a nonexempt activity as it is conducted by individuals, partnerships, and professional associations or corporations as a business and for the purpose of obtaining profits.

The provision of free, Rev. Rul. 69-161, 1969-1 C.B. 149, or low-fee, Rev. Rul. 78-248, 1978-2 C.B. 176, legal services by an organization (such as a legal aid society) to indigents otherwise financially incapable of obtaining such services is an exempt purpose under IRC 501(c)(3) because such activity relieves the poor and distressed.

The provision of legal services by a civil rights organization "to defend human and civil rights secured by law" is a charitable purpose because it promotes social welfare within the meaning of Reg. 1.501(c)(3)-1(d)(2). The purpose is to provide presentation to individuals in cases involving civil rights or individual liberties guaranteed by the United States constitution. This insures judicial attention to the recognition, delineation, and protection of these rights. Charitable classification is based upon longstanding recognition of the importance of such rights and liberties and the fact that securing such rights for each individual is of sufficiently broad public concern that their defense promotes the social welfare.

On October 9, 1970, the Service announced it was temporarily suspending the issuance of rulings on applications for exemption submitted by public interest law firms (hereafter, "PILF," the common Service shorthand) and other organizations which litigate or support litigation for what they believe is the public good in some particular area of national interest. IR No. 1069, 10-9-1970; 7 CCH para. 6937E (1970). The Service stated that a study was underway to determine whether such organizations qualified for exemption because there were no

standards or controls then in effect. This was viewed as particularly troubling when opposing sides in a lawsuit involving substantial private interests would both claim that they were acting in the public interest. Six days after the first announcement, the Service announced that foundations and other donors to PILF's could rely on the outstanding favorable rulings issued to such organizations for the support of current operations. IR No. 1072, 10-15-1970; 7 CCH para. 6938A (1970). Within another 30 days the Service issued guidelines that were incorporated in Rev. Proc. 71-39, 1971-2 C.B. 575. Section 1 of Rev. Proc. 71-39 provides that "the guidelines are to be used as an interim procedure pending amendment of the regulations defining the term "charitable" as it is used in [IRC 501(c)(3)]." The Service provides no definition of "the public interest." Rather, it merely states the guidelines that apply to organizations formed to provide legal representation in the public interest.

In 1975 the Service publicly approved IRC 501(c)(3) exemption for a PILF whose board of governors (comprised primarily of attorneys) set criteria for case selection, which did not accept cases in which private persons had a sufficient economic interest in the outcome of litigation to justify retention of private counsel, and which undertook cases which were not economically feasible for private firms. Rev. Rul. 75-74, 1975-1 C.B. 152. In this ruling the charitability of PILF's rests not upon the merits or outcome of the cases which they handle, but upon the fact that they provide representation to members of the community in cases which present issues of significant importance to the public but which, because of the lack of economic feasibility, would not usually be handled by the traditional law firm.

Not articulated in the revenue rulings or procedures but present in each PILF application for exemption is the issue of competing public interests. For example, even if litigation seeking an injunction against a business for pollution of the air or waterways in violation of some law is successful, it is not absolutely clear that the overall effect of the litigation will be beneficial to the community. An illustration of this problem is found in a decision of the Circuit Court of Appeals for the District of Columbia in Wilderness Society v. Morton, 495 F. 2d 1026 (D.C. Cir. 1974). In that case nonprofit organizations sought to enjoin the construction of the trans-Alaska pipeline. Although the plaintiffs were successful in halting construction for a period of months, subsequent Federal legislation destroyed any legal position they might have had and the suit was dismissed. After dismissal of the case, the plaintiffs asked the U.S. Court of Appeals for an award of attorneys' fees. The court split 4 to 3 and granted the requested fees. The dissenting opinion, however, states at page 1042:

> We respectfully dissent. It is difficult to see that either of these plaintiffs "acted as a 'private attorney general', vindicating a policy that Congress considered of the highest priority." Judging from Congress' most recent action, these plaintiffs have been frustrating the policy Congress considers highly desirable and of the utmost urgency.
>
> While no one questions the sincere motives of these "public interest" plaintiffs, it is not enough for a plaintiff to have a sincere feeling of self-righteous correctness in bringing litigation. There is the matter of judgment in assaying just where the public interest lies. Did the plaintiffs exercise good judgment here in bringing suit to block the Alaska Pipeline? In retrospect, we submit they did not.

The majority and dissenting opinions in Wilderness Society v. Morton illustrate the impossibility of saying that organizations which litigate in the name of some charitable end, are, in fact, benefitting the community.

While the provision of legal services will continue to be an area of increased activity, given the activist and adversary nature of contemporary society, the limits of exemption for public interest law firms seems well delineated. The question of rationalizing continued exemption with acceptance of legal fees, implicit in Morton has largely been resolved by Rev. Proc. 75-13, 1975-1 C.B. 662. The question of which competing interest group represents the "public interest" has not. The competing interests question will not be susceptible of easy, or early, solution. Other legal services provide structures such as prepaid legal services plans which seem unlikely to be included within the scope of exemption under IRC 501(c)(3) in the future unless a new theory of charitable exemption evolves. In such instances, entities similar to prepaid legal services plans may have to be given their own exemption subsection with independent rationale for exemption rather than included under the concept of charity.

j. Public Policy (Schools, Discrimination, and Demonstrations)

In determining whether an organization qualifies for exemption under IRC 501(c)(3), the Service historically has applied the common law principle that, to be treated as a charitable entity, an organization may not operate illegally or contrary to public policy. Courts have consistently held that the benefits accorded charitable organizations ought not to be made available to an organization which functions in a manner that undermines important and recognized societal values.

Present day public policy concerning racial discrimination in education has its roots in the 1954 landmark Supreme Court case, Brown v. Board of Education which ruled unconstitutional racial discrimination in public educational facilities.

As a result of these expressions of public policy, as well as numerous court decisions, the Service has taken the position, well established, but lately under legislative attack on questions of enforcement standards, that private educational institutions exempt under IRC 501(c)(3) may not discriminate on the basis of race, color, national or ethnic origin and retain exempt status.

Late in 1971, the Service published Rev. Rul. 71-447, 1971-2 C.B. 230, in which the Service stated it would deny tax-exempt status to any school which "does not have a racially nondiscriminatory policy as to students." The basis for this revenue ruling was Common Law, the Restatement of Trusts (2d), The Civil Rights Act of 1964, Brown v. Board of Education, 347 U.S. 483 (1954) and subsequent federal court cases. With regard to the public policy argument in particular the revenue ruling cites the Restatement of Trusts (2d), section 377, comment c: "A trust for a purpose the accomplishment of which is contrary to public policy, although not forbidden by law, is invalid."

The revenue ruling concluded from a reading of these authorities that "a school not having a racially nondiscriminatory policy as to students is not charitable within the common law concepts reflected in sections 170 and 501(c)(3). . ."

In Rev. Proc. 72-54, 1972-2 C.B. 834, the Service issued guidelines and recordkeeping requirements to determine whether private schools exempt under IRC 501(c)(3), or applying for exemption, have racially nondiscriminatory policies. The revenue procedure cited Rev. Rul. 71-447 and set up guidelines to publicize the fact of racially nondiscriminatory policy. Full and effective communication of the policy was the major substantive requirement of the guidelines.

Rev. Proc. 72-54 was superseded late in 1975 by Rev. Proc. 75-50, 1975-2 C.B. 587. The result of Rev. Proc. 75-50 was to make the technical and substantive requirements for nondiscrimination in private schools more comprehensive. Organizational, publicity, facilities and programs, scholarship and loan programs, applications for exemption, public complaints and racial discrimination and recordkeeping requirements were all set forth in detail.

The public policy rationale has also been used to reach decisions on organizations engaged in picketing, demonstrations, and economic boycotts. Six revenue rulings show the use of the public policy rationale by the Service in these cases and are indicative of trends in the area.

Rev. Rul. 68-438, 1968-2 C.B. 209, provided that an organization formed to lessen racial and religious prejudice in the fields of housing by conducting investigations and research to obtain information on discrimination qualified for exemption under IRC 501(c)(3). The organization met with proprietors of establishments where discrimination was observed to encourage compliance with civil rights laws but did not engage in economic boycotts, reprisals, or picketing. Similarly in Rev. Rul. 72-228, 1972-1 C.B. 148, an organization formed to promote equal rights for women primarily in connection with employment and other economic opportunities was found exempt under IRC 501(c)(3). Among the factors considered was that the organization did not promote support or engage in economic boycotts, reprisals or picketing.

An opposite result was reached by Rev. Rul. 75-384, 1975-2 C.B. 204, where an organization formed to promote world peace and disarmament by nonviolent, but illegal, civil disobedience did not qualify as exempt under either IRC 501(c)(3) or IRC 501(c)(4). The rationale for denial cited both Scott on Trusts, section 377 (3rd. Ed. 1967) and the Restatement of Trusts (2d) 1959, section 377, comment c, for the principle that under the general law of charity no trust can be created for a purpose which is illegal or its accomplishment against public policy. Similarly, in Rev. Rul. 76-81, 1976-1 C.B. 156, an antiabortion organization was recognized exempt under IRC 501(c)(4) in part because its activities were educational and not illegal or contrary to public policy and the organization did not advocate evasion or violation of existing laws.

Finally, in Rev. Rul. 77-272, 1977-2 C.B. 191, a job training program limiting admissions to American Indians was held to qualify for exemption under IRC 501(c)(3) because the limitation (required by Federal law governing funding of training programs for Indians) was not racial discrimination, was not contrary to public policy and was not inconsistent with charitable exemption under IRC 501(c)(3).

The public policy rationale will probably continue to be used, as in the past, not as a positive basis for exemption but as a requirement which when not met will result in denial of exemption.

k. Politicking

IRC 501(c)(3) provides that organizations exempt under its provisions may not carry on propaganda or otherwise attempt to influence legislation (with certain exceptions described below dealing with the substantiality test and the elective provisions of IRC 501(h)) and may not participate in, or intervene in (including the publishing or distributing of statements), any political campaign on behalf of any candidate for public office.

The first of these two provisions, that no substantial part of the activities of such organizations may constitute the carrying on of propaganda or otherwise attempt to influence legislation was added in 1934 as a floor amendment to the Revenue Act of 1934. The purpose was to prevent the deduction of contributions used solely by charitable organizations for propaganda purposes. 78 Cong. Rec. 5959 (1934). The provision found its way into the 1939 and 1954 Codes without modification. No attempts were made during this time to distinguish legislatively between propaganda, influencing legislation and "permissible" lobbying.

The Service routinely applied a "substantial part of activities" test in determining whether an organization could retain its exemption. This test applies only to organizations engaging in legislative (rather than political) "action" and is reflected in the "action" organization regulations, Reg. 1.501(c)(3)-1(c)(3)(ii) and (iv). The regulations preserve IRC 501(c)(3) status despite the advocacy by the organization of positions on controversial issues calling for social change with the intent of changing public opinion so long as the organization cannot be classified as an "action" organization. This term "action" organization was created to refer to those organizations, engaging in legislative action, which would normally qualify for IRC 501(c)(3) status but for their activities in attempting to influence legislation.

The Tax Reform Act of 1976 sought to clarify the ambiguities inherent in this requirement not to be an "action" organization by enacting an elective provision for specified IRC 501(c)(3) organizations, IRC 501(h). Also enacted were IRC 504 and IRC 4911. IRC 504 prevents the qualification, under IRC 501(c)(4), of organizations denied IRC 501(c)(3) status because of excessive expenditures for lobbying under IRC 4911. The impetus for this enactment may have been the report of the Filer Commission (Giving in America, Commission on Private Philantrophy and Public Needs, p. 181 (1975)) which was critical of the limitation on legislative activities.

IRC 501(h) and the coordinate taxing provision IRC 4911, permit "grass roots" lobbying and direct lobbying subject to dollar and percentage limitations. Those organizations that do not or are not eligible to make the election under IRC 501(h) are governed by the prior tests for "action" organizations. IRC 4911(d) defines the term "influencing legislation." Five categories are excluded from the term "influencing legislation": (1) making available the results of nonpartisan analysis, study, or research, (2) providing technical advice or assistance in response to a written request by a governmental body, (3) appearances before, or communications to, any legislative body with respect to a possible decision of that body which might affect the existence of the organization, its powers and duties, its tax-exempt status, or the deduction of contributions to it, (4) communications between the organization and its bona fide members unless the communications directly encourage the members to influence legislation or directly encourage the members to urge nonmembers to influence legislation and (5) routine communications with government officials and employees.

Although these five exceptions set out in IRC 4911(d)(2) are applicable only to eligible charitable organizations making the election of IRC 501(h), it now seems unlikely that the Service would rule that an organization subject to the older "substantial part of activities" standard is not exempt under IRC 501(c)(3) if less than a substantial part of its activities are within the exclusions of IRC 4911(d)(2). Therefore, what is and what is not influencing legislation is fairly well settled by the legislative enactment of IRC 501(h) and IRC 4911. However, legislative refinements are likely to continue given the apparent unwieldiness of applying the dollar and percentage limitations of IRC 4911, for eligible organizations exercising the election of IRC 501(h). See 1979 EOATRI topic on Lobbying, page 104.

The second of the two provisions, that an organization may not participate in or intervene in any political campaign on behalf of any candidate for public office was added to the provisions of IRC 501(c)(3) with the enactment of that provision into the 1954 Code. The provision is generally presumed to be absolute in its prohibition of intervention in political campaigns.

Recently this area has come under increased public attention and legislative scrutiny because of the Service's publication of two revenue rulings: Rev. Rul. 78-160, 1978-1 C.B. 153 and Rev. Rul. 78-248, 1978-1 C.B. 154 (which revoked Rev. Rul. 78-160).

In Rev. Rul. 78-160 the Service ruled that surveys of opinions of competing candidates for public office, as part of a voter education program, even on a nonpartisan basis, constituted impermissible intervention in a political campaign. Upon reconsideration this Revenue Ruling was revoked and a facts and circumstances test substituted. Rev. Rul. 78-248 cites four factual situations, two permissible and two impermissible. The permissible situations were: (1) the annual preparation and dissemination of Congressional voting records without comment or other indication of approval or disapproval and (2) surveying all candidates on a wide range of issues and publishing the candidates responses. The two proscribed activities were: (1) using questions that indicate a bias on certain issues and (2) restricting consideration to only one candidate or that candidate's voting record. Not stated in Rev. Rul. 78-248's factual examples but obviously still applicable as a permissible activity is the situation where the activity is not in the context of a political campaign.

It seems fair to say that with the publication of Rev. Rul. 78-248, greater certainty has been introduced into this area. Also charitable organizations are now clearly on notice of their responsibilities to examine their own activities to conform to the requirements of the revenue ruling. See 1979 EOATRI topic on Political Activities, page 124.

l. Amateur Athletic Organizations

Amateur athletic organizations were not considered to be charitable organizations. They did not fit under any definition of charity, nor were they considered charity in its generally accepted legal sense because there was no historical precedent for finding such organizations to be charitable. Instead amateur athletic organizations qualified for IRC 501(c)(3) status, if at all, under the educational rationale of IRC 501(c)(3).

To remedy the problem of exemption for organizations unable to use the advancement of education rationale, Congress enacted section 1313 of the Tax Reform Act of 1976. That section provided that exemption would be recognized for organizations organized and operated exclusively "to foster national or international amateur sports competition (but only if no part of its activities involve the provision of athletic facilities or equipment)."

The problem with this provision was the parenthetical expression which prohibited the provision of facilities or equipment. Most organizations promoting national or international amateur sports competition provided some type of

facilities or equipment to the assisted athletes. Therefore, most of these organizations would not qualify for exemption under the new provision. Also most of these organizations, because their principal purpose was fostering amateur sports competition, could not qualify as educational. In essence what the new exemption provision gave with one hand, it took away with the other. This was clearly not its intent, just the result. The legislative history indicates the provision was meant to work to preclude exemption only to social clubs and other organizations of "casual" athletes. The legislative history was clear that the new provision was not intended to adversely affect the qualification for charitable tax-exempt status or tax deductible contributions of any organization qualifying under the standards of existing law. See the topic on Amateur Athletic Organizations in this EOATRI.

4. The Evolving Concept of Charity

A variety of theories have been used to justify recognition of exemption where there is doubt that the formal requirements for recognition have been met. Meeting the organizational test is usually not a problem. The activities of charities often are. Making the determination that an organization meets the operational test of IRC 501(c)(3) is difficult where the activity is a trade or business, is not per se charitable, or is not carried out in a charitable manner, and where the activity of the organization bears only a tenuous relationship to the achievement of exempt purposes (and whether the exempt purposes themselves can actually be identified). As the earlier sections of this article have shown, charity is not a static concept. The following "theories" have been used in a variety of difficult cases to justify exemption under IRC 501(c)(3).

a. The Conduit Theory

In Rev. Rul. 68-489, 1968-2 C.B. 210, the Service ruled that an organization exempt under IRC 501(c)(3) that distributed part of its funds to organizations not themselves exempt under IRC 501(c)(3) but insured use of the funds for IRC 501(c)(3) purposes by limiting distributions to specific projects that are in furtherance of its own exempt purposes would not jeopardize its own exemption. The organization must retain control and discretion that the funds are used for IRC 501(c)(3) purposes. The principle established here is that an exempt organization may pursue its charitable purposes through organizations not exempt under IRC 501(c)(3). Thus, the recipient organization is the conduit through which the exempt organization performs its charitable purposes.

This concept is not limited to the use of organizations exempt under IRC 501(c)(3). Individuals and businesses may be the conduits through which purposes may be pursued. For example, in Rev. Rul. 72-559, 1972-2 C.B. 247, the Service ruled that an organization formed to provide a substantial amount of free legal services to low income residents of economically depressed communities through the subsidization of new lawyers may qualify for exemption under IRC 501(c)(3) because it is operated for charitable purposes. In this case the organization subsidized new lawyers for up to three years if they established private practices in economically depressed communities that had a shortage of legal services. By inducing lawyers to establish practices in such areas and to provide free legal services to low income residents, the organization relieves the poor and distressed. In this case, the Service stated:

> * * * The fact that the recipients of the organization's financial assistance, the (new lawyers), are not themselves a charitable class does not mean the organization is not operating primarily for charitable purposes. The (lawyers) are merely instruments through which the charitable purposes are accomplished. * * * (Emphasis added.)

Earlier the Service had ruled that an organization created to develop and promote an appreciation of jazz music as an American art form may qualify for exemption. (Rev. Rul. 65-271, 1965-2 C.B. 161.) The organization periodically conducted jazz festivals or concerts at which the public heard true American jazz, written and played by serious students and famous jazz musicians. The professional jazz musicians are paid for their performances. There is no indication in the ruling that the professional musicians constituted a charitable class. Implicit in this ruling is the concept articulated in Rev. Rul. 72-559 that those who perform the charitable activities are mere instruments through which charitable purposes are achieved. In accord Rev. Rul. 73-313, 1973-2 C.B. 174, 176.

The conduit theory provides an alternate approach to the performance of traditional charitable activities. This theory clearly indicates fulfillment of the promise implied in the 1959 regulations that the term "charitable" will be applied in a flexible manner to reflect current social issues and problems.

b. The Adjunct or Integral Part Theory

Under this theory an organization conducts activities not charitable in themselves. These activities would be permissible to an IRC 501(c)(3)

organization. The organization conducting the activities is controlled by one or more IRC 501(c)(3) organizations. The organization is exempt under IRC 501(c)(3) because it is an "adjunct," an

The adjunct theory was first enunciated by the Seventh Circuit U.S. Court of Appeals in 1934 in the case of Produce Exchange Clearing Assn. v. Helvering, 71 F. 2d 142 (2nd Cir. 1934). The first application of the adjunct theory to IRC 501(c)(3) [101(6); 1939 Code] organizations was in Squire v. Students Book Corporation, 191 F. 2d 1018, 1020 (9th Cir., 1951) where the Ninth Circuit U.S. Court of Appeals reviewed the tax status, for the years 1943 to 1947, of a corporation organized to operate a bookstore and restaurant on the campus of the State College of Washington. The court concluded that the organization was an educational organization exempt under IRC 101(6) of the 1939 Code. In reaching this conclusion, the court cited the effective control of the organization by the State university. Because the organization bore "a close and intimate relationship to the functioning of the college itself" the organization was an adjunct of the college and exempt.

The theory was used again in Avery Brundage v. Commissioner, 54 T.C. 1468 (1970) to permit an additional percentage deduction under IRC 170 (b)(1)(A)(ii), by virtue of the organization being described as an educational organization under IRC 503(b)(2). The organization was a museum to whom the taxpayer had made a donation of art. At issue was whether the museum was a part of the San Francisco school system. The court concluded it was an integral part of the school system and thus was an educational organization.

The adjunct theory has also been applied in a number of perpetual care cemetery cases to both grant (Endowment Care Trust Fund of Inglewood Part Cemetery Association v. U.S., 76-2 U.S.T.C. para. 9516 (1976)) and deny exemption (Rosehill Cemetery Company v. U.S., 285 F. Supp. 21 (N.D. Ill. 1969)). Cf. Washington Trust Bank v. U.S., 69-2 U.S.T.C. para. 9568 (E.D. Wash. 1969).

In a recent declaratory judgment case, Levy Family Tribe Foundation, Inc. v. Commissioner, 69 T.C. 615 (1978), the adjunct theory was used to deny exemption because the organization was an adjunct of the family business and not of an exempt organization. Also in two other recent declaratory judgment cases, the adjunct theory was mentioned as an alternative ground upon which exemption might be recognized. B.S.W. Group, Inc. v. Commissioner, 70 T.C. 352, 360 (1978) and Federation Pharmacy Services v. Commissioner, 72 T.C. 687, 692 (1979). Explicit in both cases was the court's willingness to use the theory to justify

exemption along with the court's refusal to use the theory in these cases because it was able to find that there were no exempt "parent" organizations in control.

c. The Essential Purpose Theory

With the enactment of IRC 7428, the declaratory judgment provision, by the Tax Reform Act of 1976, the "essential purpose" theory has found increasing use and favor with the courts. This theory avoids formalized requirements of IRC 501(c)(3) and concentrates instead on the essential purpose of the organization minimizing the importance of the business aspects of the organization's activities. As discussed in the section on charity under the regulations, the intent of the current regulations was to liberalize the Service position with respect to classification as charitable organizations of those social welfare organizations designed to accomplish one or more of the four enumerated social welfare purposes. Thus, for social welfare type organizations, if the essential objective, the essential purpose, of an organization is to promote social welfare by achieving any of these purposes, then the organization qualifies under IRC 501(c)(3) regardless of the fact that some or all of the individuals who benefit from the organization's activities are not members of a traditional class of charitable recipients.

The essential purpose theory inquires into the relationship between the activities of the organization and the results to be achieved and on this basis makes the determination that the organization meets, or does not meet, the requirements for exemption as a charitable organization under IRC 501(c)(3). This is very much a result-oriented test which looks to the result to determine intent and from intent, qualification as a charitable organization. Intent is, of course, almost always a question of fact derived from the facts and circumstances of the case.

Three recent declaratory judgment cases are illustrative of the test. In B.S.W. Group, Inc. v. Commissioner, 70 T.C. 352 (1978), an organization sought to provide consulting services to "limited resource" groups in the fields of health, housing, vocational skills and cooperative management. The assistance given was in the form of consulting services with the organization receiving a profit based on the client's ability to pay. In concluding that the Service's denial of exemption was correct the court stated:

> Under the operational test, the purpose toward which an organization's activities are directed and not the nature of the activities themselves, is ultimately dispositive of the organization's right to be classified as a section 501(c)(3)

> organization exempt from tax under section 501(a).... Petitioner is engaged in one and only one activity, but it is possible for such an activity to be carried on for more than one purpose .... [T]he critical inquiry is whether petitioner's primary purpose for engaging in its sole activity is an exempt purpose, or whether its primary purpose is the nonexempt one of operating a commercial business producing net profits for petitioner.

In Federation Pharmacy Services, Inc. v. Commissioner, 72 T.C. 687 (1979), the essential purpose theory was again used in the court's rationale denying exemption to an organization providing prescription drugs to its members at a discount rather than below cost:

> It is clear that petitioner's exclusive purpose for being, its raison d'etre, is to sell drugs, an activity that is normally carried on by a commercial profit-making enterprise.... Virtually everything we buy has an effect, directly or indirectly, on our health. We do not believe that the law requires that any organization whose purpose is to benefit health, however remotely, is automatically entitled, without more, to the desired exemption.... The fact that the item sold bears a relationship to health care does not remove the commercial taint or make the competition with drugstores any less disabling.

An opposite result was reached in Aid to Artisans, Inc. v. Commissioner, 71 T.C. 191 (1978) where an organization engaged in the sale of "Third World" handicrafts was found exempt. There the court stated:

> In the instant case, petitioner's primary activities are not an end unto themselves, but rather are undertaken in order to accomplish certain exempt purposes. Thus, the sale of handicrafts to exempt organizations is neither an exempt purpose as argued by petitioner nor a nonexempt purpose as argued by respondent. Rather, such sale is merely an activity carried on by Aid to Artisans in furtherance of its exempt purposes.

The essential purpose theory because it concentrates on the results of the activities of the organization seeking exemption will probably continue to be applied by the

courts where there is doubt as to whether the formal requirements of IRC 501(c)(3) are met.

d. Conclusion

Common among these theories is the fact that they permit exemption for organizations which cannot be clearly categorized as a particular type of charitable organization within the traditional types delineated in the regulations. Thus undifferentiated, the organizations rely upon these theories, or others closely akin to them, to justify exemption. As the number and variety of exempt organizations increase, the number of organizations which are unable to fit into the recognized categories will also increase. The fact that the Service has in the past denied exemption to these organizations does not necessitate a similar result today. The declaratory judgment provision for IRC 501(c)(3) organizations will result in a large number of these undifferentiated organizations obtaining exemption through the courts.