C. PRIVATE SCHOOLS

1. Introduction

During the past year, the issue of private schools and racial nondiscrimination remained active with developments in both the Congressional and the judicial areas. The purpose of the following discussion is to review those developments and to provide an overview of an additional issue, that of the relationship between day care and education under IRC 501(c)(3).

2. Racial Nondiscrimination

a. Background

Despite the activity of the past few years, described in detail in the 1980 EOATRI Textbook, the principal source of guidance in the area of private schools and racial nondiscrimination remains Revenue Procedure 75-50, 1975-2 C.B. 587. As indicated by Revenue Ruling 75-231, 1975-1 C.B. 158, all organizations operating schools, including churches operating elementary and secondary schools and hospitals operating nursing schools, must establish that the schools they operate do not discriminate on the basis of race. The guidelines of Revenue Procedure 75-50 are the means for establishing such a nondiscriminatory policy and would apply to those schools as well as independent elementary and secondary schools. The sole exception to the preceding general rule concerns private elementary and secondary schools located in Mississippi. This limited court-imposed exception is discussed in the following section on recent judicial action.

b. Recent Judicial Action

Judicial action concerning racial nondiscrimination, private schools and federal income tax has focused on the special requirements for Mississippi private schools originally flowing from Green v. Connally, 330 F. Supp. 1150 (D.D.C.), aff'd sub nom. Coit v. Green, 404 U.S. 997 (1971). On May 5 and June 2, 1980, the Green Court modified and supplemented the permanent injunction originally issued in 1971 to require the Service to survey Mississippi private schools, including church-related schools, and apply to them a test which, if failed by a school, results in a rebuttable inference of racial discrimination. Under the modified order, the Service is prohibited from:

"...according...and from continuing the tax exempt status now enjoyed by, all Mississippi private schools or the organizations that operate them, which:

(1) which have been determined in adversary or administrative proceedings to be racially discriminatory; or were established or expanded at or about the time the public school districts in which they are located or which they serve were desegregating, and which cannot demonstrate that they do not racially discriminate in admissions, employment, scholarships, loan programs, athletics, and extra-curricular programs.

(2) The existence of conditions set forth in Paragraph (1) herein raises an inference of present discrimination against blacks. Such inference may be overcome by evidence which clearly and convincingly reveals objective acts and declarations establishing that such is not proximately caused by such school's policies and practices. Such evidence might include, but is not limited to, proof of active and vigorous recruitment programs to secure black students or teachers, including students' grants in aid; or proof of continued, meaningful public advertisements stressing the school's open admissions policy; or proof of meaningful communication between the school and black groups and black leaders within the community concerning the school's nondiscrimination policies, and any other similar evidence calculated to show that the doors of the private school and all facilities and programs therein are indeed open to students or teachers of both the black and white races upon the same standard of admission or employment."

The Court went on to require those schools which are able to overcome the inference of racial discrimination to comply with publication and recordkeeping requirements beyond those required under Revenue Procedure 75-50.

c. Recent Congressional Action

As described in the 1980 EOATRI Textbook, the 1980 General Appropriations Act contained amendments expressly forbidding the use of any funds for the "formulation or carrying out" of the private schools revenue procedure first proposed by the Service in 1978 (see the 1979 EOATRI Textbook, Vol. 1). With the end of the 1980 fiscal year on September 30, 1980, the Service began operating under a Joint Congressional Resolution on Continuing Appropriations which permits operations at the same level and under the same restrictions as provided for in the 1980 General Appropriations Act. As of the date of this writing, a General Appropriations Act for fiscal year 1981 has not been passed; however, a number of amendments containing restrictions similar to those in the 1980 Act have been discussed by Congress. Accordingly, the Service is still operating under restrictions that preclude the utilization of the 1978 proposed revenue procedure and the standards discussed in it and similar restrictions may be included in any future appropriations act.

3. Day Care and Education

The question of federal income tax exemption for organizations providing day care has been one which the Service has faced since the first years of the federal income tax. The basic issue has revolved around whether organizations providing day care are educational in the sense that their activity is similar to that of a school or whether the provision of purely custodial day care is a charitable activity in its own right.

The Service's initial published position on the question was O.D. 340, 1919-1 C.B. 202, which stated that an organization, incorporated for the purpose of establishing and maintaining a day nursery for young children whose parents were obliged to work and had no means to provide care for their children during the day, and which derived its income from subscriptions and donations, and a small amount from securities, all of which was used in promoting the activities of the nursery, was exempt from taxation under section 231(6) of the Revenue Act of 1918, a predecessor of section 501(c)(3) of the Internal Revenue Code of 1954.

O.D. 340 was superseded by Revenue Ruling 68-166, 1968-1 C.B. 255, which updated and restated the earlier ruling under current law. The 1968 ruling provides a currently accurate description of the requirements for exemption under IRC 501(c)(3) for an organization providing purely custodial day care, namely that the service be provided solely to children from "needy" or low income families.

An organization providing day care may also, however, be providing a structured program of learning for the children in its care. If the organization also meets the other criteria of Reg. 1.501(c)(3)-1(d)(3)(ii), it may be recognized as exempt under IRC 501(c)(3) as a school and not have to restrict the provision of its services to low income families. The criteria of that section of the regulations include: 1) a regularly scheduled curriculum; 2) a regular faculty, and; 3) a regularly enrolled body of students in attendance at a place where the educational activities are regularly carried on. Such an educational day care situation has been described in Revenue Ruling 70-533, 1970-2 C.B. 112, and Revenue Ruling 73-430, 1973-2 C.B. 262. Furthermore, an organization may be providing structured educational activities for children at early ages as noted by the courts in the cases of San Francisco Infant School v. Commissioner, 69 T.C. 957 (1978), acquiescence, 1978-2 C.B. 2, and Michigan Early Childhood Center, Inc. v. Commissioner, T.C.M. 1978-186.

In this context, it should be noted that such educational day care organizations are classified as private schools under IRC 509(a)(1) and 170(b)(1)(A)(ii) and must follow the guidelines of Revenue Procedure 75-50, 1975-2 C.B. 587, to establish that they have racially nondiscriminatory policies as to students.

4. Conclusion

Accordingly, organizations providing day care services may be exempt from federal income tax under IRC 501(c)(3) either as schools, assuming they have a structured educational program and the other criteria of Reg. 1.501(c)(3)-1(d)(3)(ii) are present, or as charitable organizations assuming the day care services are provided solely to children of low income families.

Both day care organizations qualifying as private schools and more traditional private schools must comply with the racially nondiscriminatory guidelines of Revenue Procedure 75-50. As noted previously, more stringent court-ordered requirements regarding the demonstration of a nondiscriminatory policy have been placed on private schools located in Mississippi.