Virginia Education Fund v. Commissioner, 85 T. C. 743 (1985)

The burden of proving nondiscriminatory character of supported organizations lies with the petitioner in tax-exempt status revocation cases.

Summary

The Virginia Education Fund sought to retain its tax-exempt status under IRC Section 501(c)(3), but the IRS revoked it retroactively to 1974, citing the discriminatory practices of the private schools it funded. The Tax Court upheld the revocation, ruling that the burden of proving the schools' nondiscriminatory policies rested with the Fund. The decision emphasized the procedural aspect of the burden of proof in declaratory judgment actions and the IRS's discretion in retroactively applying revocations of tax-exempt status.

Facts

The Virginia Education Fund, established in 1958, solicited and distributed funds to private schools in Virginia. In 1961, the IRS granted it tax-exempt status under IRC Section 501(c)(3). Following a 1970 IRS policy shift against exempting racially discriminatory private schools, the IRS proposed revoking the Fund's exempt status in 1972. A 1973 technical advice memorandum suggested the Fund's status would remain intact for 1969, but a 1978 determination letter revoked the status retroactively to 1974, due to the Fund's support of schools that did not adopt racially nondiscriminatory policies.

Procedural History

The Fund initially applied for tax-exempt status in 1958, which was granted in 1961. The IRS's 1970 policy change against racially discriminatory schools led to a 1972 proposal to revoke the Fund's exempt status. A 1973 technical advice memorandum addressed the 1969 status, and a 1977 letter proposed revocation effective from 1974. The final determination letter in 1978 confirmed the revocation. The Fund filed a petition for declaratory judgment in 1979, which was denied by the Tax Court in 1985.

Issue(s)

1. Whether the burden of proving the nondiscriminatory character of the donee schools rested on the petitioner or the respondent?
2. Whether the IRS's revocation of the petitioner's exempt status could be applied retroactively to 1974?

Holding

1. Yes, because the burden of proof in declaratory judgment actions under IRC Section 7428 is on the petitioner to establish grounds set forth in the notice of

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determination, and the Fund failed to provide evidence of the schools' nondiscriminatory policies.
2. Yes, because the IRS did not abuse its discretion under IRC Section 7805(b) in making the revocation retroactive to 1974, as the Fund had notice of potential revocation since 1972.

Court's Reasoning

The Tax Court reasoned that the burden of proof in declaratory judgment actions under IRC Section 7428 follows the rules established for similar actions under IRC Section 7476. The Fund's exempt status depended on the donee schools' compliance with nondiscriminatory policies, and the Fund bore the burden of proving this compliance. The court emphasized that the IRS's determination letter focused on the schools' failure to adopt nondiscriminatory policies, not merely their noncompliance with IRS guidelines. Regarding retroactivity, the court upheld the IRS's decision under IRC Section 7805(b), citing the Fund's notice of potential revocation since 1972 and the IRS's procedural rules allowing retroactivity to the date of notice.

Practical Implications

This decision clarifies that in tax-exempt status revocation cases, the burden of proving the nondiscriminatory nature of supported organizations lies with the petitioner. It highlights the importance of maintaining compliance with IRS policies and guidelines, especially in cases involving discrimination. Practitioners should advise clients to monitor and ensure the nondiscriminatory practices of supported entities. The ruling also affirms the IRS's broad discretion in retroactively applying revocations, which underscores the need for organizations to respond promptly to IRS inquiries and notices. Subsequent cases, like *Bob Jones University v. United States*, have reinforced the IRS's position against tax exemptions for racially discriminatory institutions.

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