Calhoun Academy v. Commissioner, 94 T. C. 284 (1990)

A private school must prove by a preponderance of evidence that it operates in good faith in accordance with a racially nondiscriminatory policy to qualify for tax-exempt status under IRC section 501(c)(3).

Summary

Calhoun Academy sought a declaratory judgment that it was exempt from federal income tax under section 501(c)(3). The school, founded during a period of public school desegregation, never enrolled a black student despite a significant local black population. The Tax Court held that Calhoun Academy did not meet its burden of proof to demonstrate a racially nondiscriminatory policy, emphasizing the absence of black students and the school's historical context. The court clarified that while affirmative action is not required, schools must take steps to overcome unfavorable inferences of discrimination to secure tax-exempt status.

Facts

Calhoun Academy, a private school in South Carolina, was established in 1969 during a period of public school desegregation. It has operated continuously since the 1970-71 school year, serving grades 1 through 12 and later adding kindergarten. Despite a local population that was approximately 50% black, the school never enrolled a black student. In November 1985, the school formally announced a racially nondiscriminatory policy and amended its charter accordingly. It applied for tax-exempt status under section 501(c)(3) in 1986, which was denied by the IRS due to insufficient evidence of nondiscriminatory operation.

Procedural History

Calhoun Academy applied for tax-exempt status under section 501(c)(3) in June 1986. The IRS tentatively denied the application in April 1987, and after a conference and further correspondence, issued a final denial in February 1988. Calhoun Academy then sought a declaratory judgment from the U. S. Tax Court, which heard the case based on a stipulated administrative record and ruled in favor of the Commissioner in March 1990.

Issue(s)

1. Whether Calhoun Academy must prove by a preponderance of the evidence that it operates in good faith in accordance with a racially nondiscriminatory policy to qualify for tax-exempt status under section 501(c)(3).
2. Whether Calhoun Academy has met its burden of proof to demonstrate that it operates in good faith in accordance with a racially nondiscriminatory policy.

Holding

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1. Yes, because the Tax Court has established that the burden of proof in section 7428 and 501(c)(3) proceedings is proof by a preponderance of the evidence, as articulated in Federation Pharmacy Services v. Commissioner.
2. No, because Calhoun Academy failed to show that it operates in good faith in accordance with a nondiscriminatory policy toward black students, as evidenced by the absence of black enrollment and insufficient efforts to attract black students.

Court's Reasoning

The court applied the legal standard from Federation Pharmacy Services v. Commissioner, which requires proof by a preponderance of the evidence for tax-exempt status under section 501(c)(3). The court noted that while Revenue Procedure 75-50 provided guidelines, it was not substantive law. The court also recognized the principles from Bob Jones University v. United States, affirming that racially discriminatory schools do not qualify for tax exemption. The court found that Calhoun Academy's historical context (founded during desegregation), lack of black enrollment, and late announcement of a nondiscriminatory policy created an inference of racial discrimination. The school's evidence, including interactions with black outsiders and a formal policy statement, was insufficient to overcome this inference. The court emphasized that while affirmative action is not required, the school needed to take some steps to counteract the unfavorable evidence to meet its burden of proof.

Practical Implications

This decision sets a precedent for how private schools must demonstrate a racially nondiscriminatory policy to qualify for tax-exempt status. Schools with a history of racial discrimination must provide evidence of good faith operation beyond mere policy statements. This may include efforts to attract underrepresented groups, though affirmative action is not mandated. For legal practitioners, this case underscores the importance of thorough documentation and proactive measures to overcome historical discrimination when seeking tax-exempt status for educational institutions. Later cases, such as Virginia Education Fund v. Commissioner, have cited Calhoun Academy to reinforce the burden of proof required for tax-exempt status in similar contexts.

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