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COMMENTS

POLITICAL CONTRIBUTIONS AND TAX-EXEMPT STATUS FOR LABOR ORGANIZATIONS

Marker v. Schultz,
485 F.2d 1003 (D.C. Cir. 1973)

Plaintiffs brought suit to enjoin Treasury officials from continuing to grant or recognize the tax-exempt status of labor organizations insofar as that status applies to tax-exempt membership dues used by the union for partisan political campaigns.¹ Plaintiffs alleged that the candidates were given the equivalent of a federal financial subsidy in violation of the constitutional limits imposed upon the taxing and spending powers of Congress by article I, section 8. The district court denied plaintiffs' request for a three-judge court and ordered the complaint dismissed with prejudice.² The United States Court of Appeals for the District of Columbia affirmed and *held*: The tax-exempt status granted to labor organizations does not violate the implied first amendment ban prohibiting governmental establishment of a political movement, and consequently does not violate the constitutional limitations on congressional spending.³

The Internal Revenue Code exempts certain types of organizations

1. Plaintiffs were workers required to pay union dues under a compulsory union shop contract. In raising the particular constitutional challenge discussed, however, standing as taxpayers and private attorneys general was asserted. *Marker v. Schultz*, 485 F.2d 1003, 1004 (D.C. Cir. 1973).

2. *Id.*

3. *Marker v. Schultz*, 485 F.2d 1003 (D.C. Cir. 1973). Plaintiffs also alleged that they were being compelled to provide financial support for parties and candidates they did not approve or favor, in contravention of their rights under the first, fifth, and ninth amendments of the Constitution. *Id.* at 1004. The court disagreed and held that dissenting union members had the right to be free of political use of their dues, but that their remedies would be limited to restitution to each individual employee of that portion of his money which the union expended for political use or to an injunction prohibiting expenditures for political causes of that portion of the dissenting members' dues. *Id.* at 1005. See *Brotherhood of Ry. Clerks v. Allen*, 373 U.S. 113, 118-21 (1963); *International Ass'n of Machinists v. Street*, 367 U.S. 740, 765-70, 774-75 (1961).

from taxation,⁴ and the general power of Congress to establish these exemptions has been held constitutional.⁵ Some judicial limitations have been imposed on these statutory grants of exemption, however. The Internal Revenue Code has been construed to deny exempt status to racially discriminatory private schools⁶ and fraternal orders.⁷ Similarly, tax deductions for contributions made to those organizations have also been denied,⁸ and tax benefits accorded certain racially discriminatory organizations have been held unconstitutional.⁹ However,

4. INT. REV. CODE of 1954, § 501(c). Included among the organizations granted tax exemptions are: (1) corporations which are organized by act of Congress and are instrumentalities of the United States; (2) charitable organizations; (3) civic leagues not organized for profit; (4) labor, agricultural, and horticultural organizations; (5) business leagues, chambers of commerce, real estate boards, or boards of trade not organized for profit; (6) nonprofit social clubs; (7) fraternal societies or orders; (8) voluntary employees' beneficiary associations; (9) benevolent life insurance associations of purely local character; and (10) nonprofit credit unions without capital stock.

5. *Brushaber v. Union Pac. R.R.*, 240 U.S. 1, 21 (1916); *St. Paul Fire & Marine Ins. Co. v. Reynolds*, 44 F. Supp. 863, 866 (D. Minn. 1942); *Phipps v. Bowers*, 46 F.2d 164, 168 (S.D.N.Y. 1930), *aff'd*, 49 F.2d 996 (2d Cir.), *cert. denied*, 284 U.S. 641 (1931).

6. *Green v. Connally*, 330 F. Supp. 1150 (D.D.C.) (three-judge court), *aff'd sub nom. Coit v. Green*, 404 U.S. 997 (1971) (permanent injunction granted since tax exemption would frustrate public policy declared in post-Civil War amendments and Civil Rights Act of 1964, 42 U.S.C. §§ 2000c to 2000d-4 (1970)); *Green v. Kennedy*, 309 F. Supp. 1127 (D.D.C.) (three-judge court), *appeal dismissed sub nom. Cannon v. Green*, 398 U.S. 956 (1970) (preliminary injunction against tax exemption granted); *cf. Crenshaw County Private School Foundation v. Connally*, 343 F. Supp. 495 (M.D. Ala. 1972), *aff'd*, 474 F.2d 1185 (5th Cir. 1973), *cert. denied*, 94 S. Ct. 2604 (1974) (suit seeking to retain benefits for private school dismissed); *Bob Jones Univ. v. Connally*, 472 F.2d 903 (4th Cir.), *aff'd*, 94 S. Ct. 2038 (1974) (injunction to prevent Treasury Department from withdrawing tax exemption to private racially discriminatory university denied).

7. *McGlotten v. Connally*, 338 F. Supp. 448 (D.D.C. 1972) (three-judge court).

8. *Green v. Connally*, 330 F. Supp. 1150 (D.D.C.) (three-judge court), *aff'd sub nom. Coit v. Green*, 404 U.S. 997 (1971).

9. *McGlotten v. Connally*, 338 F. Supp. 448, 456-59 (D.D.C. 1972) (three-judge court). The court held INT. REV. CODE of 1954, §§ 501(c)(8) (exemptions granted fraternal organizations) and 170(c)(4) (deductibility of contributions to fraternal orders) violative of the fifth amendment due process clause. Although federal action was involved, the reasoning of the court was based on "state action" and equal protection considerations generally applied in fourteenth amendment cases:

Plaintiff's claim thus leads us into the murky waters of the "state action" doctrine, for we must determine whether . . . the Federal Government has supported or encouraged private discrimination so as to have itself violated plaintiff's right to the equal protection of the laws.

338 F. Supp. at 455 (footnote omitted). Tax exemptions established by INT. REV. CODE of 1954, § 501(c)(7) for racially discriminatory nonprofit social clubs were held

the denial of certain tax advantages to racially discriminatory organizations has not been extended to religious organizations. Thus, in *Walz v. Tax Commission*¹⁰ the Supreme Court held that property tax exemptions granted religious organizations did not violate the establishment clause of the first amendment. The Court reasoned that the legislative purpose of the exemption was not aimed at establishing, sponsoring, or supporting religion,¹¹ nor was there excessive governmental entanglement with religion¹² or actual sponsorship of religion.¹³ Since, as the Court recognized, the tax exemption for religious organizations resulted in at least minimal governmental involvement,¹⁴ the *Walz* Court in effect adopted a "benevolent neutrality" standard.

constitutional, however. 338 F. Supp. at 457-59.

State statutes granting tax exemptions to racially discriminatory organizations have also been held unconstitutional. *Pitts v. Department of Rev.*, 333 F. Supp. 662 (E.D. Wis. 1971) (three-judge court) (Wisconsin statutes, WIS. STAT. ANN. §§ 70.11(4), 71.01(3)(a) (1969), which provided for tax exemptions, held to violate fourteenth amendment equal protection clause when applied to racially discriminatory private organizations); *Falkenstein v. Department of Rev.*, 350 F. Supp. 887 (D. Ore. 1972) (three-judge court), *appeal dismissed*, 409 U.S. 1099 (1973) (Oregon tax exemptions, ORE. REV. STAT. §§ 307.134(1)(c), (2), 307.136, 317.080(2) (1971), held unconstitutional when applied to racially discriminatory fraternal orders).

10. 397 U.S. 664 (1970). While this is the only Supreme Court opinion on this issue, earlier lower court opinions also sustained the constitutionality of property tax exemptions to religious organizations. *Swallow v. United States*, 325 F.2d 97, 98 (10th Cir.), *cert. denied*, 377 U.S. 951 (1964); *Lundberg v. County of Alameda*, 46 Cal. 2d 644, 298 P.2d 1, *appeal dismissed sub nom.* *Heisey v. County of Alameda*, 352 U.S. 921 (1956); *Murray v. Comptroller of Treasury*, 241 Md. 383, 397-404, 216 A.2d 897, 905-09, *cert. denied*, 385 U.S. 816 (1966); *General Fin. Corp. v. Archetto*, 93 R.I. 392, 399-402, 176 A.2d 73, 77-79 (1961), *appeal dismissed*, 369 U.S. 423 (1962).

11. 397 U.S. at 672-73:

[The tax exemption] has not singled out one particular church or religious group . . . rather, it has granted exemption to all houses of religious worship within a broad class of property owned by nonprofit, quasi-public corporations [considered to be] beneficial and stabilizing influences in community life

. . . .

12. *Id.* at 674: "Elimination of exemption would tend to expand the involvement of government by giving rise to tax valuation of church property, tax liens, tax foreclosures, and the direct confrontations and conflicts that follow in the train of those legal processes."

13. *Id.* at 675: "The grant of a tax exemption is not sponsorship since the government does not transfer part of its revenue to churches but simply abstains from demanding that the church support the state."

14. *Id.* at 674.

For an analysis of the difference between a tax exemption as a tax subsidy and as a recognition of the inapplicability of taxing the exempted organization, see Bittker, *Churches, Taxes and the Constitution*, 78 YALE L.J. 1285 (1969).

Labor organizations have enjoyed tax-exempt status since 1909,¹⁵ with only limited qualifications.¹⁶ Although charitable organizations are expressly prohibited from engaging in political activity,¹⁷ Congress has repeatedly rejected proposals to enact such a prohibition for labor organizations.¹⁸

The court in *Marker* accepted without discussion the existence of an implied first amendment ban which prohibits the Government from establishing a political movement,¹⁹ but held that the tax exemption challenged did not violate that implied ban. Relying on *Walz*, the court found that the tax exemptions challenged constituted only "minimal and remote" governmental involvement having a neutral stance

15. Payne-Aldrich Tariff Act of 1909, ch. 6, § 38, 36 Stat. 113. This tax exemption was carried over into the first income tax act, Income Tax Act of 1913, ch. 16, § IIg(a), 38 Stat. 172. Today the tax-exempt status of unions is based on INT. REV. CODE OF 1954, § 501(c)(5).

16. Labor organizations, and agricultural and horticultural organizations which are entitled to exemption from taxation, must "(1) Have no net earnings inuring to the benefit of any members, and (2) Have as their objects the betterment of the conditions of those engaged in such pursuits . . ." Treas. Reg. § 1.501(c)(5)-1(a) (1958).

17. INT. REV. CODE OF 1954, § 501(c)(3).

18. Amendments denying tax exemptions for unions if dues are used in political campaigns have been defeated by the Senate. 115 CONG. REC. 37,624 (1969); 115 CONG. REC. 38,318 (1969); 117 CONG. REC. 42,371 (1971).

Federal criminal sanctions have been established to restrict union contributions to federal election campaigns. 18 U.S.C. § 610 (Supp. II, 1972) prohibits union contributions to candidates for federal office but permits the union to establish a separate fund financed by members' voluntary contributions to be used for political contributions. See *Pipefitters Local 562 v. United States*, 407 U.S. 385 (1972) (voluntary fund for conduct occurring before enactment of Federal Election Campaign Act of 1971, Pub. L. No. 92-225, 86 Stat. 10 (codified at 18 U.S.C. § 610 (Supp. II, 1972)), held permissible).

This statute has been held not to apply to statements supporting candidates made in union newspapers published regularly for union members. *United States v. CIO*, 335 U.S. 106 (1948). Expenditures for television programs supporting candidates would, however, be illegal. *United States v. UAW*, 352 U.S. 567 (1957).

19. No authority for this proposition was cited in the court's opinion or in plaintiffs' brief, nor has any supporting authority been found. This implied first amendment ban raises the question whether the provisions for federal support for political campaigns established in the 1971 modifications of the Internal Revenue Code are constitutional. Relevant sections of the Code include: INT. REV. CODE OF 1954, § 41 (allowing tax credit equal to one-half of all political contributions with maximum credit of \$12.50); *id.* § 218 (allowing as alternative to § 41 a tax deduction for political contributions up to \$50); and *id.* §§ 6096, 9001-13 (establishing "Presidential Election Campaign Fund," which allows \$1 of individual's income taxes to be provided to presidential candidates).

toward unions' political activities.²⁰ Since similarly neutral tax exemptions for religious organizations do not violate the first amendment establishment clause,²¹ the court concluded that tax exemptions to unions do not violate the ban on governmental establishment of political movements.²² The *Marker* court also distinguished on two grounds the major cases dealing with racially discriminatory organiza-

20. 485 F.2d at 1006.

21. See text accompanying notes 10-14 *supra*.

22. An alternative basis for sustaining the court's holding was also presented: the tax exemption granted labor organizations does not result in federal expenditures, and thus no federal contributions to political candidates has occurred. See note 28 *infra*. However, the entire opinion suggests that this reason is only a secondary basis for the court's holding. The racial discrimination cases were distinguished from the *Marker* situation only in terms of governmental involvement, see text accompanying notes 25-27 *infra*, not in terms of whether the particular exemption resulted in federal expenditures. Moreover, the court apparently concluded that any federal expenditures resulting from a tax exemption would not justify a taxpayer's suit challenging the constitutionality of those expenditures:

[A] tax exemption . . . does not constitute such state support for or participation in the various activities undertaken by the organizations as to be equivalent, in constitutional terms, to a tax and appropriation for those purposes.

485 F.2d at 1006.

In *Walz*, the "benevolent neutrality" standard applied was in part predicated on a balancing of two potentially conflicting constitutional doctrines, the establishment clause and the free exercise clause. Thus, the possible violation of the establishment clause had to be weighed against a possible violation of the free exercise clause by taxing religious organizations. See *Murdock v. Pennsylvania*, 319 U.S. 105 (1943) (municipal ordinance taxing religious organization for distributing literature violates first amendment). A somewhat similar situation may exist with respect to the question of union political contributions presented in *Marker*. The implied prohibition of Government establishment of a political movement may conflict with possible first amendment rights of expression and political support. In *United States v. CIO*, 335 U.S. 106 (1948), the Court construed the federal statute prohibiting contributions or expenditures by labor organizations in connection with federal elections not to apply to publications made by the union in the regular course of business. The Court stated that with an opposite construction, "the gravest doubt would arise in our minds as to its constitutionality." *Id.* at 121. See *Speiser v. Randall*, 357 U.S. 513, 518 (1958) ("To deny an exemption to claimants who engage in certain forms of free speech is in effect to penalize them for such speech"). See also Ferman, *Congressional Controls on Campaign Financing: An Expansion or Contraction of the First Amendment*, 22 AM. U.L. REV. 1, 22-23 (1972):

Alternative remedies which do not restrict expression but rather promote the governmental interest by expanding expression have constitutional preference in first amendment adjudication. Such alternatives as free broadcast time or mailing privilege, public subsidization of a campaign, or tax incentives for contributions avoid invading the first amendment protected areas and are compatible with the basic assumptions of democratic self-government that the first amendment emphasizes.

tions.²³ The court noted first that the laws challenged in those cases provided for positive Government support, including tax deductibility to donors making supporting contributions,²⁴ and secondly, that the constitutional rights protected by the post-Civil War amendments prevent even "minimal and remote involvement" that may foster racial discrimination.²⁵

Plaintiffs' contention in *Marker* that the federal government is in effect giving federal funds to political candidates was dependent upon a determination that the tax exemption granted to labor organizations is equivalent to a tax subsidy. Two methods of analysis are possible to verify whether a particular tax exemption is a subsidy: (1) the legislative history may be examined to determine if the exemption was intended to provide economic support;²⁶ or (2) the exemption may be examined to determine if it functions as a subsidy.²⁷ In the latter,

23. *McGlotten v. Connally*, 338 F. Supp. 448 (D.D.C. 1972) (three-judge court); *Green v. Connally*, 330 F. Supp. 1150 (D.D.C.) (three-judge court), *aff'd sub nom. Coit v. Green*, 404 U.S. 997 (1971). See notes 7-9 *supra* and accompanying text.

24. Tax deductions for donations to charitable organizations, permitted by INT. REV. CODE OF 1954, § 170, have been viewed as a mark of governmental approval of the recipient organizations. *McGlotten v. Connally*, 338 F. Supp. 448, 462 (D.D.C. 1972). While union dues are tax deductible as business expenses of the dues-paying member, Treas. Reg. § 1.162-15 (1958), if a substantial part of a labor union's activities consists of political activity, a deduction is not allowed for the portion used for political contributions. *Id.* § 1.162-20(c)(3). Thus the provision for tax deductions for union dues need not be viewed as evidence of governmental approval of union political contributions.

25. *Pitts v. Department of Rev.*, 333 F. Supp. 662, 668 (E.D. Wis. 1971) (three-judge court); *Green v. Connally*, 330 F. Supp. 1150, 1167 (D.D.C.) (three-judge court), *aff'd sub nom. Coit v. Green*, 404 U.S. 997 (1971).

Even under the special standard for racial discrimination cases, state support by furnishing necessary services, such as police and fire protection, is not constitutionally objectionable. *Moose Lodge No. 107 v. Irvis*, 407 U.S. 163, 173 (1972).

26. Under this analysis, a finding that the exemption was established for a purpose other than to provide economic benefits to the exempted organization would permit a conclusion that a tax subsidy did not exist, but rather that the legislative intent in creating the exemption was to define taxable income.

The court in *Marker* seemed to employ this approach. The court stated that the tax exemption to labor organizations was based on the concept that a pooling of individual resources was involved, as contrasted with entrepreneurial profit of corporations, and that plaintiffs are not protected by the Constitution from a governmental decision that union dues are not proper objects of taxation. Thus the court seemed to conclude that the legislative intent was not to provide for federal expenditures to labor organizations, but rather was to determine that union funds are not proper objects of taxation.

27. This analysis was used in *McGlotten v. Connally*, 338 F. Supp. 448 (D.D.C. 1972) (three-judge court), in holding that the tax exemptions granted fraternal orders were tax subsidies, but the exemptions to nonprofit social clubs were only

functional analysis two steps are required. First, the overall tax policy must be evaluated to establish what types of funds are to be taxed.²⁸ Then the exemption in question must be scrutinized to determine if the funds exempted are of the type that would be taxed, absent the exemption.²⁹ While the *Marker* court apparently adopted the legislative intent approach, the functional analysis can also lead to a conclusion that a tax subsidy does not result from tax exemptions granted to unions. The union's funds may be considered a collection of individual members' business expenses and as such may not be the type of funds that are taxed generally.³⁰

A conclusion that a subsidy does not exist would permit only a constitutional challenge based on a governmental involvement theory, analogous to a "state action" argument, that the Government was so involved with the activities of the private organization that the conduct of the private organization may be imputed to the Government. It

income-defining provisions. INT. REV. CODE OF 1954, §§ 511, 512(a) provide that the income of nonprofit social clubs, including passive investment income, is taxed at the regular corporate rates with a deduction for "exempt function income," defined essentially as income derived from members. The passive investment income of fraternal orders is not taxed. *Id.* The court reasoned that "exempt function income" is not the sort of income usually taxed and that the provision for tax exemption was only income-defining. Since the passive investment income of fraternal orders is not taxed, the court concluded that federal economic benefit is being provided, and thus, a tax subsidy exists. A critical commentary on this technique is given in Bittker & Kaufman, *Taxes and Civil Rights: "Constitutionalizing" the Internal Revenue Code*, 82 YALE L.J. 51 (1972).

28. Bittker & Kaufman, *supra* note 27, state that to distinguish subsidies from income-defining provisions requires the acceptance of an "ideal" income tax base that defines all the taxable income. This "ideal" income tax can then serve as a standard to determine when various tax provisions result in deviation from the "ideal" tax. *Id.* at 63. This article, however, went on to note that no income tax law in this country even closely approached the "ideal" income tax base. *Id.* at 64.

29. Labor organizations are similar to fraternal orders in that the passive investment income of neither type of organization is taxed. However, the court in *McGlotten v. Connally*, 338 F. Supp. 448 (D.D.C. 1972) (three-judge court), may have used the "subsidy" finding more to demonstrate improper Government approval than to prove impermissible federal financing. Logically, if the passive investment income represents the only funds for which the tax exemption operates as a subsidy, then only the exemption for the passive investment income should be disallowed. In addition, the *McGlotten* court coupled the "subsidy" finding with a finding that the tax exemption to fraternal orders was provided only to particular organizations with particular purposes, rather than across the board, thus indicating Government approval. Thus the *McGlotten* court may have relied more on governmental involvement considerations than on federal expenditure considerations.

30. See notes 26 & 28 *supra*.

has been held, however, that a tax exemption alone is insufficient governmental involvement in the activities of the private organization to constitute governmental participation in those activities.³¹

Even assuming a tax subsidy exists, *Walz* indicates that limited governmental economic benefits are not constitutionally barred when provided to private organizations that engage in conduct in which the Government could not participate because of constitutional prohibitions. The only cases prohibiting even "minimal and remote" governmental involvement are those cases in which the constitutionally prohibited conduct was racially discriminatory.³² Thus the standard appears to be that, except for cases involving racial discrimination, "minimal and remote" governmental involvement resulting from the grant of a tax exemption does not violate constitutional prohibitions on Government conduct.

31. *Chicago Joint Bd., Amalgamated Clothing Workers v. Chicago Tribune Co.*, 435 F.2d 470 (7th Cir. 1970), *cert. denied*, 403 U.S. 906 (1971); *Browns v. Mitchell*, 409 F.2d 593 (10th Cir. 1969); *Eaton v. Grubbs*, 329 F.2d 710, 713 (4th Cir. 1964); *Family Forum v. Archdiocese of Detroit*, 347 F. Supp. 1167 (E.D. Mich. 1972); *Bright v. Isenbarger*, 314 F. Supp. 1382 (N.D. Ind. 1970), *aff'd*, 445 F.2d 412 (7th Cir. 1971).

32. For supporting cases, see notes 6 & 9 *supra*.