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BUT REVEREND, WHY DOES YOUR BAPTISMAL FONT
HAVE A DIVING BOARD?
EQUITABLE TREATMENT FOR VOWS OF POVERTY
UNDER THE FEDERAL INCOME TAX

J. TIMOTHY PHILIPPS*

I. INTRODUCTION

In 1977 the Internal Revenue Service (IRS or Service) issued a revenue ruling¹ that drastically changed its position concerning the imposition of federal income tax on members of traditional bona fide religious orders who have taken a vow of poverty. Under these vows a member of the order renounces all wealth and promises to give any income to the religious order. The position taken in the ruling (and maintained by the IRS in subsequent litigation) is essentially two-fold. First the IRS concedes that income earned by a member of a religious order² on account of services performed directly for the order or for the church (or a related entity) with which the order is affiliated and given to the order in conformity with the member's vow of poverty is not includible in the member's income.³ In such situations the IRS treats the member as having earned the income as an agent of the order,⁴ continuing the IRS' pre-1977 policy regarding services performed directly for the order, church, or affiliated entities. Second, however, the IRS contends that if the member performs services for an employer not affiliated with the order's church, the member must include any income received for the services in the member's own gross income, even though all the income is remitted to the order in conformity with the member's

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1. Rev. Rul. 77-290, 1977-2 C.B. 26 [hereinafter Rev. Rul. 77-290].

2. A member of a religious order will sometimes be referred to in this article as a "religious."

3. See Rev. Rul. 77-290, *supra* note 1, at 26. The ruling warns, however, that the income may be taxable to the order as unrelated business taxable income, even though the order qualifies as a tax exempt organization under I.R.C. § 501(c)(3). See I.R.C. §§ 511-13. All Internal Revenue Code citations in this article are to the Internal Revenue Code of 1986 unless otherwise indicated.

4. Rev. Rul. 77-290, *supra* note 1, at 27.

vow of poverty,⁵ reversing the IRS' pre-1977 policy. The Service, nevertheless, has conceded that the member may be entitled to a charitable deduction (subject to the usual limitations) for amounts turned over to the order.⁶

The Service's reversal of position has been aggressively developed for approximately the last ten years. The IRS previously had been quiescent on the issue of taxing members of religious orders.⁷ The result of the IRS' post-1977 policy has been that earnings of members of religious orders working on missions related to their religious ministries have become subject to federal income taxation in situations not previously covered by the federal income tax. Reported cases imposing taxes have included a priest working as a chaplain in a secular hospital,⁸ a nun performing nursing services in a charitable medical clinic,⁹ a nun working as a para-legal in a legal-aid clinic,¹⁰ a nun working as a counselor and physical therapist at a research and medical center,¹¹ a nun working as a librarian in a public library,¹² a nun working as a secretary and counsellor in an alcoholic rehabilitation clinic,¹³ a chaplain at a state hospital for the mentally disabled,¹⁴ and a priest teaching in the Religious Studies Department of a state university.¹⁵ Undoubtedly, many similar situations have occurred in which the imposition of tax on the individual religious has not been contested.¹⁶

The abrupt change in IRS policy during the 1970s was unfair from a policy standpoint and at least questionable from a legal standpoint. This article first discusses the history and background of taxing religious order

5. See *id.* In Revenue Ruling 77-290, the Service held that a member of a religious order under a bona fide vow of poverty who took a position as an attorney with a private law firm had to include compensation received from the firm and turned over to the member's order. In contrast, a religious who worked directly for her church business office as a secretary did not have to include amounts received on account of those services and turned over to the order.

6. Rev. Rul. 77-436, 1977-2 C.B. 25, 26; Rev. Rul. 76-323, 1976-2 C.B. 18, 19. The amount of the deduction normally would be limited by I.R.C. § 170(b)(1)(A) to 50% of the member's adjusted gross income. See I.R.C. § 170(b)(1)(A). Moreover, the Service has taken the position in at least one letter ruling that the amount of the contribution must be reduced by any amounts the member receives from the order for living expenses. See Priv. Ltr. Rul 8-104-011, reprinted in 11 FED. TAXES (P-H) ¶55029 (1981). The ruling is unclear about whether the IRS would include in this reduction the value of goods and services received in kind such as meals and lodging taken in a convent. *Id.*

7. See *infra* text accompanying notes 23-35 (discussing Service's vow of poverty policy prior to Rev. Rul. 77-290).

8. Hogan v. United States, 57 A.F.T.R.2d 86-338 (D. Me. 1985).

9. Schuster v. Commissioner, 84 T.C. 764 (1985), *aff'd*, 800 F.2d 672 (7th Cir. 1986).

10. Luechtefeld v. Commissioner, 54 T.C.M. (P-H) ¶85,227 (1985).

11. Young v. Commissioner, 54 T.C.M. (P-H) ¶85,228 (1985).

12. Laurent v. Commissioner, 54 T.C.M. (P-H) ¶85,229 (1985).

13. Woltering v. Commissioner, 54 T.C.M. (P-H) ¶85,230 (1985).

14. McEneaney v. Commissioner, 55 T.C.M. (P-H) ¶86,413 (1986).

15. Fogarty v. United States, 55 A.F.T.R.2d 85-416, 6 Cl. Ct. 612 (1984), *aff'd*, 780 F.2d 1005 (Fed. Cir. 1986).

16. Informal discussion with members of religious orders indicates that some orders have simply chosen not to contest the issue.

members and analyzes the most prominent litigated cases. Finally, this article makes suggestions about how the courts or Congress might better resolve the issue.

II. HISTORY AND BACKGROUND

Vows of poverty, as expressions of religious faith, have long been entrenched in the Western tradition.¹⁷ Members of Roman Catholic Church religious orders traditionally have taken vows of poverty, obedience, and chastity, requiring them to renounce worldly goods, give unquestioning obedience to their religious superiors, and practice sexual abstinence.¹⁸ In the Roman Catholic Church religious order members may be nuns, brothers, or ordained priests.

Contrary to a popular misconception, not all ordained priests are members of a religious order who take the traditional vows of poverty, obedience, and chastity. Most ordained priests are so-called "diocesan" priests who perform services for and receive compensation from the diocese in which they are located. The Catholic Church regards the compensation as the priests' to keep and do with as they see fit. The priests are classified as independent contractors for federal tax purposes.¹⁹ The priests pay federal and state income taxes on compensation received from the diocese and whatever other income they receive.²⁰

By contrast, the Catholic Church does not consider priests who are members of religious orders to receive compensation in their own right, but rather on behalf of their religious order. These priests are under a religious obligation to give the order any compensation they receive.²¹ Nuns and brothers²² are under a similar obligation.

17. See generally SACRAMENTUM MUNDI 67-70 (K. Rahner ed. 1970) (discussing religious orders); 12 NEW CATHOLIC ENCYCLOPEDIA 287-93 (McGraw-Hill 1967) (discussing religious life).

18. See generally CODE OF CANON LAW, Part III, *Institutes of Consecrated Life and Societies of Apostolic Faith* (A. Mitchell trans. 1983) [hereinafter CODE OF CANON LAW].

19. See Whelan, "Church" in the Internal Revenue Code: The Definitional Problems, 45 FORDHAM L. REV. 885, 889 n.2 (1977).

20. Diocesan priests also usually are subject to the social security self-employment tax, although they may, on a one shot basis, elect out of the social security system if they are conscientiously opposed to participation in national insurance programs or opposed to such programs because of their religious principles. See I.R.C. § 1402(e); *Blakeley v. Commissioner*, 720 F.2d 411 (5th Cir. 1983). In addition Diocesan priests often receive their lodging tax-free. See I.R.C. § 107.

21. See CODE OF CANON LAW, *supra* note 15, at Canon 668. Canon 668 provides: Can. 668 § 1 Before their first profession, members are to cede the administration of their goods to whomsoever they wish and, unless the constitutions provide otherwise, they are freely to make dispositions concerning the use and enjoyment of these goods. At least before perpetual profession, they are to make a will which is valid also in civil law.

§ 2 To change these dispositions for a just reason, and to take any action concerning temporal goods, there is required the permission of the Superior who is competent

A. O.D. 119

The Service's original, and for nearly 50 years only, official public pronouncement on the vow of poverty issue, O.D. 119,²³ was published in 1919. O.D. 119 provided in its entirety:

A clergyman is not liable for any income tax on the amount received by him during the year from the parish of which he is in charge, provided that he turns over to the religious order of which he is a member, all the money received in excess of his actual living expenses, on account of the vow of poverty which he has taken.

Members of religious orders are subject to tax upon taxable income, if any, received by them individually, but are not subject to tax on income received by them merely as agents of the orders of which they are members.²⁴

In practice, the Service applied this ruling to exclude from gross income amounts paid to a religious order member and turned over to the order in accordance with that member's vow of poverty.²⁵ The lack of any reported litigation on this issue until the 1970s suggests that the Service adhered to its O.D. 119 policy of excluding from the religious' gross income amounts turned over to a religious order. In fact, the Service reaffirmed this position in a 1944 letter issued pursuant to General Counsel Memorandum 24,316.²⁶

in accordance with the institute's own law.

§ 3 Whatever a religious acquires by personal labour, or on behalf of the institute, belongs to the [order]. Whatever comes to a religious in any way through pension, grant or insurance also passes to the institute, unless the institute's own law decrees otherwise.

§ 4 When the nature of an [order] requires members to renounce their goods totally, this renunciation is to be made before perpetual profession and, as far as possible, in a form that is valid also in civil law; it shall come into effect from the day of profession. The same procedure is to be followed by a perpetually professed religious who, in accordance with the norms of the [order's] own law and with the permission of the supreme Moderator, wishes to renounce goods, in whole or in part.

§ 5 Professed religious who, because of the nature of their [order], totally renounce their goods, lose the capacity to acquire and possess goods; actions of theirs contrary to the vow of poverty are therefore invalid. Whatever they acquire after renunciation belongs to the [order], in accordance with the [order's] own law.

Id.

22. Brothers are male religious order members who are not ordained priests, for example the Christian Brothers.

23. 1 C.B. 82 (1919). In 1919 the Internal Revenue Service was officially titled the Bureau of Internal Revenue. To avoid awkwardness of expression this article will in all instances refer to the IRS by its present official name.

24. *Id.*

25. See Priv. Ltr. Rul. 81-04-005, reprinted in 1981 Fed. Taxes (P-H) ¶55,029 (1981 private letter rulings); Gen. Couns. Mem. 24,316 (1944); Reply Brief of Petitioner-Appellant at 15 and app. B-427, *Schuster v. Commissioner*, 800 F.2d 672 (7th Cir. 1986).

26. Gen. Couns. Mem. 24,316 (1944).

That letter, apparently issued to a Roman Catholic organization, stated that the issue was "tax liability of members of religious orders who are subject to vows of poverty . . . who individually perform services under circumstances resulting in compensation being paid for such service by organizations other than the religious order of which they are members."²⁷ The ruling concluded that "in such circumstances" the member is "merely an agent, trustee, or conduit for transmission of the money received to the order."²⁸ Therefore "moneys received" by the member "under such circumstances is not income."²⁹ Moreover, the letter explicitly stated that this conclusion was in conformity with O.D. 119.³⁰ The Service clearly was applying the gross income exclusion of O.D. 119 very broadly. Just as clearly, members of bona fide religious orders relied on this interpretation over the many years following the publication of O.D. 119.³¹

The reliance by members of bona fide religious orders on the Service's broad interpretation of O.D. 119's gross income exclusion was buttressed in 1968 when the Service published a second ruling dealing with vows of poverty.³² The taxpayer in that ruling was a registered nurse who also was a member of a religious order exempt from tax under IRC § 501(c)(3). The specific issue was the includability of amounts the taxpayer received from a hospital for whom the taxpayer worked. The ruling stated that all compensation earned by the taxpayer was placed in the Order's treasury and that the taxpayer had no right to direct any disposition of the Order's funds. The details of the taxpayer's daily activities were under the supervision of the hospital. The Order, however, "made all arrangements for taxpayer's assignment to the hospital," and the taxpayer remained under the Order's "general direction and control."³³

The Order requested that the taxpayer's checks be paid directly to it, but the hospital instead issued the checks to the taxpayer who, in turn endorsed them over to the Order. The ruling did not mention whether the hospital was controlled by the Order, an affiliated church, or some outside organization. The Service concluded:

It is apparent that taxpayer was performing services for the hospital as agent of the [Order], since at all times she remained under its general direction and control. Because of this relationship she had no right to receive or direct the use or disposition of the checks issued to her by the hospital for her own benefit.³⁴

27. *Id.*; Brief of Petitioner-Appellant at app. B-429; *Schuster v. Commissioner*, 800 F.2d 672 (7th Cir. 1986) [hereinafter *Schuster* Brief].

28. Gen. Couns. Mem. 24,316 (1944); *Schuster* Brief, *supra* note 27, at app. B-430.

29. Gen. Couns. Mem. 24,316 (1944); *Schuster* Brief, *supra* note 27, at app. B-430.

30. Gen. Couns. Mem. 24,316 (1944); *Schuster* Brief, *supra* note 27, at app. B-430.

31. Informal discussions with members of religious orders indicate uniformly that they relied on this interpretation to exclude such compensation from their income.

32. Rev. Rul. 68-123, 1968-1 C.B. 35, *clarified by* Rev. Rul. 83-127, 1983-2 C.B. 125.

33. *Id.*

34. *Id.* at 36.

Consequently, the compensation was not includable in the taxpayer's gross income.³⁵ At the advent of the 1970s, therefore, the Service in both its published pronouncements and actual practice had never contested exclusion from gross income of amounts received by members of religious orders who turned such receipts over to their orders in accordance with bona fide vows of poverty.

B. Mail Order Churches

In the 1970s the IRS became seriously concerned with a phenomenon popularly known as the "illegal tax protester movement."³⁶ The Service defines a tax protester as "a person who advocates and/or participates in a scheme with a broad exposure that results in an illegal underpayment of taxes."³⁷ Although the movement was not new,³⁸ it was during the 1970s that the problem began to proliferate and become widespread.³⁹

Tax protester schemes take many forms.⁴⁰ The scheme relevant to this discussion involves the creation of bogus churches to avoid payment of taxes.⁴¹

35. *Id.*

36. See generally *IRS Response to Illegal Tax Protester Movement*, Hearing Before the Subcommittee on Commerce, Consumer, and Monetary Affairs of the House Committee on Government Operations, 99th Cong., 1st Sess. 2 (1981) [hereinafter *IRS Response*].

37. *Id.* at 2, 129.

38. *Id.* at 131. The tax protester movement began during the 1920s in the West and Southwest. *Id.*

39. *Id.* at 34, 131.

40. See *id.* at 131-32. The Service has broken down such schemes into several categories:

1. *Constitutional Basis*—Refusal to include tax return information on return because of a claim of constitutional rights, e.g., the fifth amendment;
2. *Fair Market Value*—Reduces gross income because of declining value of dollar;
3. *Gold/Silver Standard*—Claims that only gold or silver currency can be taxed;
4. *Blank Form 1040*—Generally only the taxpayer's name and address, and possibly signature, and Form W-2 attached, is given;
5. *Nonpayment Protest*—Nonpayment or under payment of tax because of protest return;
6. *Church-Related*—Taxpayer receives income from nonreligious sources and declares that it is nontaxable because of vow of poverty or claims a charitable deduction for amounts claimed to be given to a self-created church;
7. *Protest Adjustment*—The return contains specific unallowable items identified to protest;
8. *W-4/W-4E—Excessive Overstatement of Exemption or Claim of Tax Exempt Status*—To avoid withholding of taxes;
9. *Family Estate Trust*—Taxpayer creates a trust which he controls, turns assets and assigns income to it, and claims he is not taxable on the trust income even though it is used to pay his personal living expenses;
10. *Other*—Miscellaneous schemes and correspondence (e.g., cards, letters).

See *id.*

41. See Note, *Mail Order Ministries, The Religious Purpose Exemption and the Constitution*, 33 TAX LAW. 959 (1980) (extensive discussion of church related schemes) [hereinafter *Mail Order Ministries*].

This scheme (or scam) actually has two distinct approaches. Under one approach an individual taxpayer forms a branch of a "church," usually by obtaining forms and credentials from a mail-order purveyor of such items. At the same time, the individual becomes a minister of the "church" and "contributes" his residence and a percentage of his income to the "church." The church in turn provides benefits such as lodging in the residence, automobiles, and vacations disguised as religious retreats. The taxpayer claims a charitable deduction for his contribution to the "church" and a section 107 "parsonage" exclusion for his lodging.⁴² He also claims that expense for use of the automobile and vacations are not includable in gross income because he incurs the expenses while carrying on church activities.⁴³ Under this scheme the individual's purported tax benefits usually will be circumscribed by the 50 percent maximum charitable contribution limitation.⁴⁴

A second approach that promises even greater tax benefits is the bogus vow of poverty. Under the bogus vow of poverty approach, the taxpayer forms a branch of a church and takes a "vow of poverty," usually by a preprinted form provided by the "mother church."⁴⁵ The taxpayer then assigns all his assets and his income to the "church" or his own "religious order" which he, of course, controls. His house becomes a "monastery," his recreation room a "chapel," and his swimming pool a "baptismal font." He claims that his income is not taxable to him because, on account of the "vow of poverty," the church or order, not he, is entitled to the income.⁴⁶

An illustrative recent example of this kind of scheme is *United States v. Ebner*,⁴⁷ a criminal tax fraud case. In *Ebner* the taxpayers were approached by a disbarred lawyer who was national head and "Archbishop" of the Life Science Church (LSC). The "Archbishop" told the taxpayers that the principal belief of LSC was that Americans were overtaxed and had the right to choose not to pay taxes.⁴⁸ The "Archbishop" offered to sell the taxpayers a "bishopship" that would enable them to sell "ministries" to the public for \$3000 each. The taxpayers would keep \$2500 and transfer the remaining \$500 to the "Archbishop." The "Archbishop," in turn,

42. I.R.C. § 107. Section 107 provides:

In the case of a minister of the gospel, gross income does not include—

(1) the rental value of a home furnished to him as part of his compensation;

or

(2) the rental allowance paid to him as part of his compensation, to the extent used by him to rent or provide a home.

Id.

43. *IRS Response*, *supra* note 36, at 137-38; *Mail Order Ministries*, *supra* note 41, at 960.

44. See I.R.C. § 170(b)(1)(A).

45. See, e.g., *Shadduck v. Commissioner*, 54 T.C.M. (P-H) ¶ 85,265, at 85-1167 n.2 (1985).

46. See *IRS Response*, *supra* note 36, at 138.

47. 782 F.2d 1120 (2d Cir. 1986).

48. *Id.* at 1122.

would supply a set of minister's credentials. The new "ministers" would then recruit other new ministers. The taxpayers all took "vows of poverty," each assigning his assets and income to his own personal church. In the words of the *Ebner* court:

The "minister" would close all of his personal bank accounts and open at least one checking account in the name of his church, over which the "minister" would exercise full control. The "minister's" personal expenses, which often included luxury items such as cars, boats, or, in [one taxpayer's] case, a "baptismal" (swimming) pool in his backyard, were paid out of church funds and were characterized for tax purposes as authorized expenses of a tax-exempt "church" for the support of its "minister" and to fulfill the "church's" religious and charitable purposes.⁴⁹

One of the taxpayers told a colleague that he was going ahead with the scheme because this "might be his last chance to be a millionaire."⁵⁰

The taxpayers stopped paying taxes on the basis of their vows of poverty. Over the tax years in question one taxpayer had earned about \$1.7 million, another \$650,000 and another \$590,000. The taxpayers earned most of their income from the sale of "ministries." The taxpayers "used 'church' funds to pay for Cadillacs, ocean front homes, and boats, and also to establish bank accounts in other countries."⁵¹ The taxpayers' criminal fraud conviction was upheld by the circuit court, which characterized the churches as "bogus" and the vows of poverty as "sham[s]."⁵²

Although the *Ebner* case is particularly egregious, it is by no means unique. As Judge Kaufman has said:

Every year, with renewed vigor, many citizens seek sanctuary in the free exercise clause of the first amendment. They desire salvation not from sin or from temptation, however, but from the most earthly of mortal duties—income taxes.⁵³

Literally a parade of cases exist in which taxpayers have blatantly used the guise of a church to evade taxes.⁵⁴

49. *Id.* at 1123.

50. *Id.* at 1122-23 n.2.

51. *Id.* at 1124.

52. *Id.* at 1122.

53. *Mone v. Commissioner*, 774 F.2d 570 (2d Cir. 1985).

54. See *Pollard v. Commissioner*, 786 F.2d 1063 (11th Cir. 1986). For example, in *Ecclesiastical Order of the Ism of Am.*, the court found that the "church" was operated for the substantial non-exempt purpose of avoiding the payment of Federal income taxes. Included in the church's literature was the statement, "Run your business with business-like finesse, and you'll never be the business of the IRS." *Ecclesiastical Order of the Ism of Am.*, 80 T.C. 833 (1983), *aff'd*, 740 F.2d 967 (6th Cir. 1984). In *Solander v. Commissioner* the taxpayer named his branch of the Universal Life Church "Old Saint Lucifer's," presumably in honor of the devil. *Solander v. Commissioner*, 51 T.C.M. (P-H) ¶82,161 (1982). In *Carr Enterprises*,

The IRS properly has been concerned with the proliferation of church related tax protester schemes. The IRS has had difficulty, however, with the sensitive first amendment problems associated with challenging an alleged church.⁵⁵ The Service has attempted to avoid these first amendment problems by bypassing the question of whether the alleged church or religion is bona-fide.⁵⁶ The IRS has maintained a policy of trying to treat all church-related

Inc. v. United States the taxpayer testified that both before and after he was ordained as a minister in his "church" he was a practicing Roman Catholic. *Carr Enterprises, Inc. v. United States*, 698 F.2d 952, 953 (8th Cir. 1983). In *Kitcher v. Commissioner* the taxpayer formed his branch of the Freedom Church of Revelation and became a minister for the avowed purpose of becoming exempt from income taxation. *Kitcher v. Commissioner*, 55 T.C.M. (P-H) ¶86,041 (1986). The court characterized the taxpayer's actions as "blatant tax avoidance" and "pie-in-the-sky." *Id.* In *Stephenson v. Commissioner* the Court said that the taxpayers had engaged in "a transparent attempt 'to transmute the commercial into the ecclesiastical.'" *Stephenson v. Commissioner*, 748 F.2d 331 (6th Cir. 1984) (quoting *McGahan v. Commissioner*, 76 T.C. 480 (1981)). In *Basic Bible Church v. Commissioner* the court found that the "church" was formed for "the purpose of confounding tax collection." *Basic Bible Church v. Commissioner*, 739 F.2d 265, 268-69 (7th Cir. 1984). In *Manson v. Commissioner* the court found that the taxpayer "used [the church] primarily as his incorporated pocketbook" and that "[t]he primary purpose for [the church's] continued existence was to give colorable justification for [taxpayer's] attempt to insulate a substantial portion of his salesman's earnings from taxation." *Manson v. Commissioner*, 49 T.C.M. (P-H) ¶80,315 (1980). In *Pusch v. Commissioner* the taxpayer at least had a motive other than personal tax avoidance. *Pusch v. Commissioner*, 49 T.C.M. (P-H) ¶ 80,004 (1980). He founded the Church of the Tolerants because he believed tax exemptions for "bigot churches" are unconstitutional. *Id.* Therefore, he claimed exemption for himself in order to test the constitutionality of the exemption. *Id.* In *Speakman v. Commissioner* the court found that the taxpayer, a truck driver-minister, was attempting to use the constitutional protection for free exercise of religion "as a sword to evade payment of taxes, rather than as a shield permitting the free exercise of religion." *Speakman v. Commission*, 54 T.C.M. (P-H) ¶85,171, at 86-747 (1985) (quoting *Wilcox v. Commissioner*, 54 T.C.M. (P-H) ¶85,243, at 85-1062 (1985)). In *United States v. Daly* the taxpayers used their churches' funds "to pay living expenses, to purchase furs, cars, planes, boats, gold coins, and real estate, to invest, to maintain country club memberships and to take foreign ski trips." *United States v. Daly*, 756 F.2d 1076, 1083 (5th Cir. 1985). There was sufficient evidence to find their vows of poverty to be "bad faith shams." *Id.* In *Lynch v. Commissioner* the taxpayer remained a Roman Catholic after becoming a minister in his church. The Court found his vow of poverty to be a sham. *Lynch v. Commissioner*, 49 T.C.M. (P-H) ¶80,464 (1980).

55. See *IRS Response*, *supra* note 36, at 3 (statement of William J. Anderson, General Accounting Office). William Anderson stated that

[i]n any event, though, this is the most difficult for IRS to cope with because of first amendment concerns, trying to make that distinction between what is a legitimate church and what is something else, whatever you would call it.

Id.

56. See IRS MANUAL, EXEMPT ORGANIZATION HANDBOOK 344.2(4). The IRS Exempt Organization Handbook contains the following warning:

The Supreme Court has suggested that serious constitutional questions would be presented if [section 501(c)(3)] were interpreted to exclude even those beliefs that do not encompass a Supreme Being in the conventional sense. . . .

Id. In *Universal Life Church, Inc. v. United States* the court refused to question the validity of the Universal Life Church as a religion: "Nor will the court praise or condemn a religion, however excellent or fanatical or preposterous it might seem." *Universal Life Church, Inc. v. United States*, 372 F. Supp. 770, 775 (E.D. Cal. 1974). Some observers believe that, in the Burger Court's final years, the Supreme Court interpreted the First Amendment to the

cases based on norms that do not refer to the bona fides of the particular religious claim.⁵⁷ This policy has in turn led to a reversal of the former IRS policy regarding traditional religious orders.⁵⁸ The IRS formally announced the reversal of its policy pertaining to traditional religious orders in Revenue Ruling 77-290,⁵⁹ and the reversal has been implemented further by several subsequent rulings.⁶⁰

C. Bona Fide Vows of Poverty

The contrast of bona fide vows of poverty to mail order ministries is exemplified in the case of *Schuster v. Commissioner*.⁶¹ The taxpayer in *Schuster*, Sister Francine, was a nun in a Roman Catholic religious order that had been incorporated in 1886 under Illinois law. The Order was exempt from federal income tax under IRC § 501(c)(3). The Order's stated purposes were

[t]o conduct schools and places of learning and to promote education, to advance the cause of Religious and Social Work, to conduct hospitals and institutions for the care and treatment of suffering humanity and to do all and everything necessary or convenient for the accomplishment of any of the purposes or objects and powers above mentioned or incidental thereto.⁶²

advantage of the majority religions at the expense of the minority religions. See, Teitele, *The Supreme Court's 1984-85 Church-State Decisions: Judicial Paths of Least Resistance*, 21 HARV. C.R.-C.L. L. REV. 651 (1986).

57. See Whelan, *supra* note 19, at 927. There are two problems with refusing to analyze the validity of a § 501(c)(3) religion. First, the term religion is the clear determining factor in applying § 501(c)(3); ignoring this term is tantamount to the courts assuming the authority of Congress. See 44 CONG. REC. 4151 (1909). Second, the federal courts have not shied away from analyzing the validity of religions in other contexts, such as determining 50 U.S.C. § 456(J) Conscientious Objector (C.O.) status. See *Gillette v. United States*, 401 U.S. 437 (1970); *Welsh v. United States*, 398 U.S. 333 (1969); *United States v. Seeger*, 380 U.S. 163 (1964). In *Seeger* the statutory language required conscientious objection to be based upon "religious training and belief" which refers to "belief in a relation to a Supreme Being involving duties superior to those arising from any human relation." *Seeger*, 380 U.S. at 173. The court held that a meaningful belief occupying the position of God fulfilled this requirement. *Id.* at 173-80. In other words, the courts expanded the definition despite specific congressional statutory language to the contrary. *Welsh* followed the same line of reasoning as *Seeger* and resulted in a dramatic concurrence by Justice Harlan. *Welsh*, 398 U.S. at 344-67. Harlan concurred on the basis of the doctrine of stare decisis. See *id.* at 345. The concurrence admits that the decisions in both *Seeger* and *Welsh* impermissibly ignore statutory construction. *Id.* at 344-45. Harlan continues by saying that since the statute clearly limits the exemption to theistic beliefs, the court should decide whether the statute violates the first amendment. *Id.* at 345.

58. See *infra* notes 59-60 and accompanying text (discussing revenue rulings that reverse IRS' pre-1977 policy regarding traditional religious orders).

59. 1977-2 C.B. 26. This reversal of policy had been foreshadowed in Rev. Rul. 76-323, 1976-2 C.B. 18. See Rev. Rul. 76-323, 1976-2 C.B. 18 (inclusion in income required where order required all members to take purely secular jobs such as plumbing).

60. Rev. Rul. 84-13, 1984-1 C.B. 21; Rev. Rul. 81-267, 1981-2 C.B. 196; Rev. Rul. 80-332, 1980-2 C.B. 34; Rev. Rul. 79-132, 1979-1 C.B. 62; Rev. Rul. 78-229, 1978-1 C.B. 305.

61. 84 T.C. 764 (1985), *aff'd*, 800 F.2d 672 (7th Cir. 1986).

62. *Id.* at 765.

Roman Catholic canon law⁶³ required Sister Francine, as a member of the Order, to take vows of chastity,⁶⁴ poverty,⁶⁵ and obedience.⁶⁶ Under her vow of poverty, Sister Francine executed a "Declaration Concerning Remuneration" in which she agreed "never to claim any wages, compensation, remuneration, or reward . . . for the time or for the services or work that [she] perform[ed] for . . . [the Order]."⁶⁷

Members of the Roman Catholic Order were allowed to secure employment in occupations relating to the Order's purposes. Such employment, termed a mission, had to be approved by the nun's Superiors.⁶⁸ This approval depended on whether the proposed mission related to "religious and charitable works that promote education, relieve suffering, and otherwise provide assistance to those in need."⁶⁹ Each member of the Order who received a mission was duty bound under her vow of obedience to perform the mission and could not withdraw from it without permission from her Superiors. In addition, each member was obligated to obey any orders of her Superiors regarding the mission even to the point of withdrawing from the mission if so ordered.⁷⁰

63. See CODE OF CANON LAW *supra* note 18, at Canon 598. Canon 598 provides: Can. 598 § 1 Each [order], taking account of its own special character and purposes, is to define in its constitutions the manner in which the evangelical counsels of chastity, poverty and obedience are to be observed in its way of life.

§ 2 All members must not only observe the evangelical counsels faithfully and fully, but also direct their lives according to the [order's] own law, and so strive for the perfection of their state.

Id.

64. See CODE OF CANON LAW, *supra* note 18, at Canon 599. Canon 599 provides: Can. 599 The evangelical counsel of chastity embraced for the sake of the Kingdom of heaven, is a sign of the world to come, and a source of greater fruitfulness in an undivided heart. It involves the obligation of perfect continence observed in celibacy.

Id.

65. See CODE OF CANON LAW, *supra* note 18, at Canon 600. Canon 600 provides: Can. 600 The evangelical counsel of poverty in imitation of Christ, who for our sake was made poor when he was rich, entails a life which is poor in reality and in spirit, sober and industrious, and a stranger to earthly riches. It also involves dependence and limitation in the use and the disposition of goods, in accordance with each [order's] own law.

Id.

66. See CODE OF CANON LAW, *supra* note 18, at Canon 601. Canon 601 provides: Can. 601 The evangelical counsel of obedience, undertaken in the spirit of faith and love in the following of Christ, who was obedient even unto death, obliges submission of one's will to lawful Superiors, who act in the place of God when they give commands that are in accordance with each [order's] own constitutions.

Id.

67. *Schuster*, 84 T.C. at 765.

68. See CODE OF CANON LAW, *supra* note 18, at Canon 671. Canon 671 provides: Can. 671 Religious are not to undertake tasks and offices outside their own [order] without the permission of the lawful Superior.

Id.

69. *Schuster*, 84 T.C. at 766.

70. *Id.* The order in *Schuster* had at times in the past required such a withdrawal.

Under their vows of poverty, members of the Order were not entitled to a return of any of the income generated by their mission work, but rather the Order was entitled to it. Therefore, the Order required members to remit to it all funds paid to members for work performed on a mission.⁷¹ If a member should withdraw from the Order, she had no right to demand compensation for her work while a member of the Order.⁷² The Order, however, might provide relocation and transition funds to the departing member.⁷³

Taxpayer, Sister Francine, was a registered nurse. She was awarded a traineeship for nurse-midwife training from the federal government. As a condition of the grant Sister Francine agreed to practice in a "health manpower shortage area" for a 12 month period for each academic year of the traineeship.⁷⁴ Sister Francine received permission from the Order to interview for positions that would fulfill this requirement. Subsequently, Sister Francine received word that a position was available for her at Su Clinica Familiar, a family health services program under the auspices of Catholic Charities of the Diocese of Brownsville, Texas.⁷⁵

Sister Francine received permission from her Superior to accept this position in furtherance of the Order's purposes to relieve suffering and promote life. Pursuant to that permission, the Acting Provincial Administrator of the Order wrote a letter to the Director of Midwifery at Su Clinica offering the services of Sister Francine on behalf of the Order.⁷⁶ Sister

71. *Id.* See CODE OF CANON LAW, *supra* note 18, at Canon 668. Canon 668 provides in pertinent part:

Can. 668 * * *

§ 3 Whatever a religious acquires by personal labor, or on behalf of the [order] belongs to the [order]. . . .

Id.

72. *Schuster*, 84 T.C. at 767. See CODE OF CANON LAW, *supra* note 18, at Canon 702 § 1. Canon 702 provides in pertinent part:

Can. 702 § 1 Whoever lawfully leaves a religious [order] or is lawfully dismissed from one, cannot claim anything from the [order] for any work done in it.

Id.

73. See CODE OF CANON LAW, *supra* note 18, at Canon 702 § 2. Canon 702 provides in pertinent part:

Can. 702 * * *

§ 2 The [order], however, is to show equity and evangelical charity to the member who is separated from it.

Id. In one recent instance the amount provided a departing member was \$500. *Schuster* Brief, *supra* note 27, at 6.

74. *Schuster*, 84 T.C. at 767-68.

75. *Id.* at 786 n.2 (Korner, J., dissenting); *Schuster* Brief, *supra* note 27, at 8.

76. *Id.* at 769. In *Schuster* the Acting Provincial Administrator for Sister Francine's Order wrote a letter to the director of the nurse-midwifery service at Su Clinica Familiar in which the Acting Provincial Administrator stated in pertinent part:

Sister Francine Schuster has informed us of your recent phone notification of a current job opening in nurse midwifery at Su Clinica Familiar, Raymondville-Harlingen, Texas. Harlingen, Texas.

The Community of Adorers of the Blood of Christ [the Order] would like to contract

Francine was to receive an appointment from and be paid through the National Health Services Corps (NHSC) that was providing funding for Su Clinica at the time. Consequently, the Acting Provincial Administrator also wrote to NHSC offering Sister Francine's services. This letter informed NHSC of Sister Francine's status as a member of the Order and that she would be acting under her vow of poverty as a member of the Order.⁷⁷ The director of the midwifery clinic at Su Clinica, also a nun, responded by accepting the offer and advising that Sister Francine simply endorse her checks over to the Order.⁷⁸ No record exists of any response from NHSC.⁷⁹

Sister Francine then became employed at the clinic as a nurse-midwife. She lived at a convent house of the Sisters of Divine Providence. Her room and board were paid by the Order.⁸⁰ She received a personal expense allowance from the Order of no more than \$35 per month, a standard personal expense allowance of the Order. No relationship existed between the amount of the allowance and the amount of Sister Francine's compen-

with you for the services of Sister Francine Schuster, ASC for the position of nurse-midwife for one year at Su Clinica Familiar.

If our offer is acceptable, we request that payment for her services be made to the Adorers of the Blood of Christ.

Id.

77. *Id.* at 769-70. In *Schuster* the Acting Provincial Administrator for Sister Francine's Order sent a letter to the National Health Services Corps in which the Acting Provincial Administrator stated in pertinent part:

Sister Francine Schuster has informed us of your recent phone notification of a current job opening in nurse midwifery at Su Clinica Familiar, Raymondville-Harlingen, Texas.

The Community of Adorers of the Blood of Christ would like to contract with you for the services of Sister Francine Schuster, ASC for the position of nurse-midwife for one year at Su Clinica Familiar.

If our offer is acceptable, we request that payment for her services be made to the Adorers of the Blood of Christ.

* * *

[Sister Francine] is a member in good standing of [the Order] . . . and is, therefore . . . under vow of poverty . . . her services are performed as part of the duties required to be performed by the member for/or on behalf of the Order as its agent; and . . . all salaries or grants received by her accrue to the . . . [Order] because of her vow of poverty.

Id.

78. *Id.* at 770. In *Schuster* the director of the nurse-midwifery service at the Su Clinica Familiar sent the Acting Provincial Administrator for the Community of Adorers of the Blood of Christ the following response to the Acting Provincial Administrator's offer of Sister Francine's services:

Consider this letter as formal acceptance of Sister Francine Schuster on our nurse-midwifery staff. She will be beginning on the pay period that starts July 23. Sister Francine's checks will be paid to her and she can endorse them and send them to you. I endorse my checks 'paid to the order of the Sisters of St. Mary. Sister Angela Murdaugh.' There is no problem with them going through the mail like that.

Id.

79. *Id.*

80. *Schuster* Brief, *supra* note 27, at 8.

sation for her clinic work.⁸¹ Compensation was paid by NHSC directly to Sister Francine. Upon receipt of each check Sister Francine would endorse the check to the Order and mail it to a post office box maintained by the Order.⁸² Sister Francine retained no control over the funds remitted to the Order.⁸³

The Tax Court, in an eleven to seven decision, held that the compensation for Sister Francine's services at the clinic was includible in her own gross income.⁸⁴ Relying on *Lucas v. Earl*,⁸⁵ the majority found that Sister Francine had made an invalid assignment of income.⁸⁶ The majority further found that the assignment of income was invalid, because NHSC formally hired Sister Francine and paid her directly.⁸⁷ Finally, the majority in *Schuster* found that NHSC contracted with Sister Francine for her services and did not contract with the Order.⁸⁸ According to the majority, Sister Francine received the compensation in her own right and not as agent of the Order, and, consequently, Sister Francine, not the Order, was taxable on that income.⁸⁹

The Tax Court majority apparently accepted the Commissioner's "triangle theory" of agency.⁹⁰ The triangle theory of agency requires that for an agency relationship to arise for income tax purposes in a case in which a taxpayer, allegedly acting as agent of a principal, performs services for a third party, two factors must be present: 1) there must be "some indicium of an agreement" between the alleged principal and the third party; and 2) the principal must have the right to direct or control the taxpayer's service or performance in some meaningful sense.⁹¹

From the standpoint of agency law, the triangle theory is dubious. The agency relationship is defined in the Restatement (Second) of Agency as "the fiduciary relationship which results from the manifestation of consent by one person to another that the other shall act on his behalf and subject to his control, and consent by the other so to act."⁹² This is precisely the

81. *Schuster*, 84 T.C. at 767.

82. *Id.* at 771.

83. *Id.* at 766-67, 773.

84. *Id.* at 764-78.

85. 281 U.S. 111 (1930).

86. 84 T.C. at 773-78.

87. *Id.* at 775-78.

88. *Id.*

89. *Id.*

90. *Id.* at 784-85.

91. See *id.* at 776 (citing *Johnson v. Commissioner*, 78 T.C. 882 (1982), *aff'd mem.*, 734 F.2d 20 (9th Cir. 1984); *Vnuk v. Commissioner*, 621 F.2d 1318 (8th Cir. 1980); *Vercio v. Commissioner*, 73 T.C. 1246 (1980). *Johnson* required inclusion in income by a professional basketball player whose team steadfastly refused to contract with the player's personal services corporation but rather would contract only with the player himself. *Johnson*, 78 T.C. at 886. *Vnuk* and *Vercio* both involved the estate trust tax protester scheme. *Vnuk*, 621 F.2d at 1319-21; *Vercio*, 73 T.C. at 1259. See *supra* note 36 (discussing categories of tax protestor schemes).

92. RESTATEMENT (SECOND) OF AGENCY § 1(1) (1957).

relationship Sister Francine entered into with the Order when she became a member. Furthermore, Sister Francine's potential status as an employee of Su Clinica or NHSC does not preclude her from remaining the Order's agent at the same time.⁹³ The triangle theory requires that the third party always be aware of and deal directly with the principal. The triangle theory would, therefore, if taken to its logical conclusion, preclude agency relationships involving an undisclosed principal. Such a conclusion is patently at odds with the settled agency law.⁹⁴

Even if one accepts the triangle theory as valid, the facts in *Schuster* do not support its application. In *Schuster* the Order informed Su Clinica of Sister Francine's status and made clear in its letter to the clinic that Sister Francine was acting as an agent of the Order. The clinic accepted that arrangement.⁹⁵ Sister Francine was, as a matter of economic reality, an employee of the clinic, even though she was paid through NHSC and was NHSC's nominal employee, presumably to satisfy its paperwork requirements.⁹⁶ NHSC basically was a provider of funds on behalf of the clinic.

Should one go so far as to accept that NHSC was Sister Francine's employer, the facts in *Schuster* still do not support the triangle theory's application. The Order informed NHSC of Sister Francine's situation and that she would be "acting on behalf of the Order as its agent."⁹⁷ NHSC did not object to this arrangement.⁹⁸ NHSC at least implicitly accepted Sister Francine's agency status.

The United States Court of Appeals for the Seventh Circuit, in a two to one decision, affirmed the Tax Court's finding that Sister Francine was taxable on the amounts in question.⁹⁹ The Seventh Circuit, however, explicitly refused to follow the Tax Court's triangle theory.¹⁰⁰ Rather, the Seventh Circuit adopted a "flexible test" that requires consideration of several factors that the majority deemed relevant.¹⁰¹ Applying these factors to Sister Francine's situation, the majority concluded that Sister Francine

93. *Schuster*, 84 T.C. at 785 (Korner, J., dissenting). An agent can act as principal at the same time with respect to two principals and to the same responsibilities so long as service to one principal does not constitute an abandonment of the other. *Id.*; see RESTATEMENT (SECOND) OF AGENCY § 226 (1957).

94. See RESTATEMENT (SECOND) OF AGENCY §§ 186, 190 (1957) (recognizing efficacy in certain cases of acts of agent on behalf of undisclosed principal). See *Schuster*, 84 T.C. at 787 n.3 (Korner, J., dissenting).

95. See *supra* notes 76-78 (quoting correspondence between clinic and Order in *Schuster*).

96. *Schuster*, 84 T.C. at 786 n.2 (Korner, J., dissenting).

97. *Id.* at 783.

98. *Id.*

99. *Schuster v. Commissioner*, 800 F.2d at 672 (7th Cir. 1986).

100. *Id.* at 678.

101. *Id.* The court listed six separate factors adopted in *Fogarty v. United States* as being relevant for a determination of whether compensation received by a religious is taxable. *Id.* at 677; see *Fogarty v. United States*, 780 F.2d 1005 (Fed. Cir. 1986); *infra* text accompanying note 151 (quoting *Fogarty* court factors).

"earned her wages in her individual capacity, rather than as an agent on behalf of her Order."¹⁰²

A vigorous dissent¹⁰³ pointed out that, on proper analysis of the undisputed facts, the agency factors listed by the majority cut in favor of, rather than against, Sister Francine's position.¹⁰⁴ The Order at all times had exercised ultimate control over Sister Francine's activities at Su Clinica. The Order authorized her mission there,¹⁰⁵ exercised oversight over her activities there,¹⁰⁶ and received Sister Francine's paychecks endorsed to the Order by her. Sister Francine's vow of obedience required her to be completely subservient to the will of her superiors. The only plausible way to deny the Order's control over Sister Francine would be to deny the sincerity of her vows.

Three other recent cases *Fogarty v. United States*,¹⁰⁷ *Hogan v. United States*,¹⁰⁸ and *McEneaney v. Commissioner*¹⁰⁹ involved priests rather than nuns.¹¹⁰ In *Fogarty*, Father Fogarty was appointed to the position of associate professor in the Religious Studies Department at the University of Virginia. The University issued monthly payroll checks payable to Father Fogarty. He, in conformity with his instructions, deposited the payroll checks in an account of the Corporation of Roman Catholic Clergymen, an account of the Jesuit Order. All of the checks payable to Father Fogarty were turned over to the Order. Father Fogarty exercised no control over the payroll checks, and the Order, in turn, provided him with living expenses.¹¹¹

102. *Schuster*, 800 F.2d at 678.

103. *Id.* at 679 (Cudahy, J., dissenting). Judge Cudahy remarked in his dissent: I am sure that Justice Holmes, keeping track of our work at his celestial *Lexis* terminal, is appalled to find his much-cited opinion invoked by the government and the Tax Court to extract taxes from a poverty-pledged nun doing corporal works of mercy on behalf of a religious community.

Id.

104. *Id.* at 680-82.

105. *See Schuster*, 84 T.C. at 783. Sister Francine, in fact, informed NHSC that she would accept a position only with Su Clinica and not with any other clinic. *Id.* This was in conformity with her mission from the Order. *Id.*

106. *See Schuster*, 800 F.2d at 682. In *Schuster*, for example, Sister Francine was under a duty while on a mission to decline any assignments that conflict with the moral principles of the Order. *Id.* In accordance with this duty she informed Su Clinica that she could not participate in the clinic's artificial birth control activities. *Id.*

107. *Fogarty v. United States*, 780 F.2d 1005 (Fed. Cir. 1986), *aff'g* 6 Cl. Ct. 612 (1984).

108. *Hogan v. United States*, 57 A.F.T.R.2d 86-338 (D. Me. 1985).

109. *McEneaney v. Commissioner*, 55 T.C.M. (P-H) ¶ 86,413 (1986).

110. Two of the priests, Father Fogarty and Father Hogan, were members of the Society of Jesus, popularly known as Jesuits. St. Ignatius Loyola founded the Society of Jesus and Pope Paul III sanctioned it in 1540. Jesuits lay special emphasis on the vow of obedience, especially to the Pope. They also stress flexibility, allowing for a great variety of ministries. Education and scholarship have been the Society's principal work. *See* 6 ENCYCLOPEDIA BRITANNICA 541 (5th ed. 1985). Father McEneaney was a member of the Congregation of the Sacred Hearts of Jesus and Mary.

111. *Fogarty*, 780 F.2d at 1007.

In *Hogan*, Father Hogan had been a chaplain at a Catholic hospital. The hospital merged with another hospital and thereby became secular in nature. A condition of the merger, however, was that the new entity retain a Catholic chaplain. Father Hogan, accordingly, remained in the position of chaplain. He received salary checks from the hospital which he turned over to the Jesuit Order. Father Hogan's duties were essentially the same both before and after the merger.¹¹²

In *McEneaney*, a state hospital for the mentally disabled requested the Archdiocese of Los Angeles to provide it with a chaplain to minister to the spiritual needs of its patients. The Archdiocese in turn requested Father McEneaney's Order to appoint one of its members as chaplain.¹¹³ The Order's Superior directed Father McEneaney to take the position. Father McEneaney endorsed all his paychecks to the Order upon receiving them. Father McEneaney's duties at the hospital were entirely sacerdotal. He had no secular duties. Moreover, the hospital administration exercised no control or supervision over him.¹¹⁴

In each case the court found that the income was taxable to the priests individually.¹¹⁵ The *Hogan* and *McEneaney* courts apparently accepted the Commissioner's triangle agency theory. For Father Hogan to avoid taxability, the *Hogan* court required a showing that the hospital had formally contracted with the Jesuits for his services. No formal contract had been executed for the two years in question.¹¹⁶ The *McEneaney* court enunciated a similar requirement and found that Father McEneaney had failed to meet it.¹¹⁷

In *Fogarty*, however, the Federal Circuit rejected the triangle theory. The *Fogarty* court refused to make a contract between the employer and the Order a *sine qua non* of an agency relationship. Rather the court said that such a contract is only one of several factors to be taken into account in determining whether an agency relationship exists among the employer, the religious, and the order.¹¹⁸ Nevertheless, although the facts in *Fogarty* admittedly presented "a very close case" the Federal Circuit refused to reverse the lower court's decision that Father Fogarty was the taxable party.¹¹⁹

112. *Hogan*, 57 A.F.T.R.2d at 86-338 to 86-339.

113. *Id.* at 86-1886.

114. *Id.* In *McEneaney* Father McEneaney testified as follows:

They say well we can't tell you how to say mass, and how to give the sacraments, so we leave that all up to you.

Id.

115. *Fogarty*, 780 F.2d at 1013; *Hogan*, 57 A.F.T.R.2d at 86-343; *McEneaney*, 55 T.C.M. (P-H) ¶86,413, at 86-1890.

116. *Hogan*, 57 A.F.T.R.2d at 86-343. Subsequently the hospital and Jesuits did enter into a formal contract for the provision of Father Hogan's services as chaplain. *Id.* n.13.

117. *McEneaney*, 55 T.C.M. (P-H) ¶86-413, at 86-1890 (1986).

118. *Fogarty*, 780 F.2d at 1012. See *infra* text accompanying note 151 (quoting other relevant factors enumerated by *Fogarty* court).

119. *Fogarty*, 780 F.2d at 1013.

The foregoing cases present a sharp contrast to the mail order church situation. Moreover, these cases are easily distinguishable from the one case before the issuance of Revenue Ruling 77-290 that found taxability of a taxpayer who had taken a bona fide vow of poverty. In *Kelley v. Commissioner*,¹²⁰ the taxpayer was a member of the Dominican Order. However, the taxpayer had gone on leave from the Order to make a determination about whether he wished to remain in the Order. The taxpayer obtained a position as a philosophy professor at a college. The taxpayer received salary checks over which he retained control, maintained an apartment for himself, purchased a car in his own name, wore non-clerical garb, and, in general, lived a secular life.¹²¹ The taxpayer eventually left the Order permanently.

The Tax Court in *Kelley* correctly held the taxpayer taxable on this income, since the taxpayer controlled it entirely. During the period in question neither the taxpayer nor his salary was in any way controlled by the Order.¹²² This contrasts with *Schuster, Fogarty, Hogan, and McEneaney* in which the taxpayers continued to live the religious life and abide by their vow of poverty by relinquishing control over the salaries to their respective orders. It is difficult, for example, to imagine facts much more compelling for income exclusion than were present in *McEneaney*.

III. *Poe v. Seaborn* and *Lucas v. Earl*: COMPETING ANALOGIES

In all the vow of poverty cases both sides have agreed on certain basic legal principles. First, under *Maryland Casualty Co. v. United States*,¹²³ when an agent earns income on behalf of a principal within the scope of the agency and remits the income to the principal in accordance with the agency relationship, the income is the principal's and not the agent's.¹²⁴ Second, under *Lucas v. Earl*,¹²⁵ income is taxable to the person who earns it, and an anticipatory assignment of that income is not effective to shift the incidence of taxability.¹²⁶ Third, under *Poe v. Seaborn*,¹²⁷ a shifting of income that occurs by operation of law, such as state community property laws, will be recognized for federal income tax purposes.¹²⁸ Fourth, under

120. 62 T.C. 131 (1974).

121. *Id.* at 134.

122. A later case, *Macior v. Commissioner*, presented a similar set of facts. *Macior v. Commissioner*, 53 T.C.M. (P-H) ¶84-1003 (1984). Although the taxpayer in that case remained a member of the Order, he essentially abandoned his vow of poverty by maintaining control over his salary as a University professor of biology. *Id.* at 84-1004.

123. 251 U.S. 342 (1920).

124. *Id.* at 347.

125. 281 U.S. 111 (1930).

126. *Id.* at 114-15.

127. 282 U.S. 101 (1930).

128. *Id.* at 110.

Order of St. Benedict of New Jersey v. Steinhauer,¹²⁹ a religious order's ownership rights that arise from Canon Law and a member's vow of poverty will be enforced by the civil law.¹³⁰

The Commissioner has taken the position that the controlling analogy is *Lucas v. Earl*. In *Earl* a husband, by agreement before enactment of the income tax, assigned a portion of his future income to his wife. The court held that this agreement was ineffective to shift the husband's income to the wife for federal income tax purposes.¹³¹ The Commissioner has argued that the religious order member who takes a vow of poverty is like the husband in *Earl*.¹³² He is attempting simply to assign his income to the order. Therefore, absent other factors, such as an actual contract between the order and a third party employer for the member's services, income earned on account of those services is taxable to the member individually.¹³³

Taxpayers have argued that the more appropriate analogy is *Poe v. Seaborn*,¹³⁴ decided only a few months after *Earl*. In *Seaborn* the Court decided that the community property laws of Washington state were effective to cause income earned entirely by one spouse to be taxed equally to both spouses.¹³⁵ The Court attempted to distinguish *Earl* on the basis that the very status of marriage operated under the community property law to prevent the earnings from ever being subject to the earning spouse's control.¹³⁶ By contrast, in *Earl* the wife had a right to the husband's earnings

129. 234 U.S. 640 (1914). See also *Watson v. Jones*, 80 U.S. (13 Wall.) 679 (1871); *Rosicrucian Fellowship v. Rosicrucian Fellowship Non-Sectarian Church*, 245 P.2d 481, 487-88 (Cal. 1952), cert. denied, 345 U.S. 938 (1953); *Canovaro v. Brothers of Order of Hermits of St. Augustine*, 191 A. 140, 146 (1937); *Maas v. Sisters of Mercy of Vicksburg*, 99 So. 468, 470 (1924). *Sisters of Mercy of Vicksburg*, 135 Miss. 505, _____, 99 So. 468, 470 (1924).

130. See *Steinhauer*, 234 U.S. at 648-52 (civil law will enforce religious order's ownership rights arising from Canon Law and member's vow of poverty when member has voluntary right of withdrawal from order).

131. *Lucas v. Earl*, 281 U.S. 111, 114-15 (1930). The *Earl* court reasoned that [t]his case is not to be decided by attenuated subtleties. It turns on the import and reasonable construction of the taxing act. There is no doubt that the statute could tax salaries to those who earned them and provide that the tax could not be escaped by anticipatory arrangements and contracts however skilfully devised to prevent the salary when paid from vesting even for a second in the man who earned it. That seems to us the import of the statute before us and we think that no distinction can be taken according to the motives leading to the arrangement by which the fruits are attributed to a different tree from that on which they grew.

Id.

132. *Hogan*, 57 A.F.T.R.2d at 86-341.

133. *Id.* at 86-343.

134. 282 U.S. 101 (1930).

135. *Id.* at 118.

136. *Id.* at 117. The *Seaborn* case distinguished *Lucas v. Earl* on the basis that [t]he very assignment in that case [*Lucas v. Earl*] was bottomed on the fact that the earnings would be the husband's property, else there would have been nothing on which it could operate. That case presents quite a different question from this, because here, by law, the earnings are never the property of the husband, but that of the community.

Id.

because of the husband's voluntary agreement to assign to her a portion of his income, and not by reason of the status of marriage.

In reality the facts of the two cases are not very different.¹³⁷ In both cases a taxpayer performed a voluntary act. In *Earl* the act was entering into the assignment agreement; in *Seaborn* the act was marrying and living in the state of Washington. Each act had the effect of giving the taxpayer's spouse the right to a portion of his income. In each case, the taxpayer could have avoided the consequence of that act, either by not entering the assignment agreement or by not marrying or living in a community property state. To that extent both taxpayers voluntarily had assigned their income.

The *Fogarty* court attempted to distinguish *Seaborn* from the vow of poverty situation on the ground that the *Seaborn* result depended on the operation of state community property laws, whereas the vow of poverty is a voluntary agreement similar to the one entered into by the husband in *Earl*.¹³⁸ This distinction reflects the *Fogarty* court's misunderstanding of a religious vows' function in the Roman Catholic Church. The Catholic Church, as do other churches, exists under two laws: 1) an ecclesiastical law that creates and defines the church's internal structure; and 2) civil law.¹³⁹ In any given instance the civil law may or may not give effect to the Church's ecclesiastical law internal structure.¹⁴⁰ For example, in an early case, *Order of Saint Benedict of New Jersey v. Steinhauser*, the United States Supreme Court upheld the enforceability of a vow of poverty under civil law.¹⁴¹ However, the Court in *Steinhauser* enforced the vow as a matter of civil contract law, not on account of the member's status as a religious under the ecclesiastical law.¹⁴²

In Roman Catholic ecclesiastical law the taking of religious vows results in a special status as a member of an "Institute of Consecrated Life."¹⁴³ In the eyes of the Catholic Church, the taking of religious vows entails far more than the mere making of a contract. Taking religious vows involves entering a special status analogous to entering the married state.¹⁴⁴ The

137. See M. CHIRELSTEIN, FEDERAL INCOME TAXATION, A LAW STUDENT'S GUIDE TO THE LEGAL CASES AND CONCEPTS 8.01, at 161-62 (4th ed. 1985). In *Commissioner v. Harman* Justice Douglas observed in his dissent that the two cases "state competing theories of income tax liability." *Commissioner v. Harman*, 323 U.S. 44, 56 (1944) (Douglas, J., dissenting).

138. 780 F.2d at 1009.

139. See *Whelan*, *supra* note 19, at 903.

140. See *id.* at 903-06.

141. *Order of St. Benedict of New Jersey v. Steinhauser*, 234 U.S. 640 (1914). The *Steinhauser* case involved the claims of a religious order against the estate of a member who, in violation of his vow of poverty, had not turned over to the order certain royalty payments received by him. *Id.*

142. *Id.* at 648-52.

143. See generally CODE OF CANON LAW, *supra* note 18.

144. See, e.g., CODE OF CANON LAW, *supra* note 18, at Canon 607. Canon 607 provides: Can. 607 § 1 Religious life, as a consecration of the whole person, manifests in the Church the marvelous marriage established by God as a sign of the world to come. Religious thus consummate a full gift of themselves as a sacrifice offered to God,

traditional reference in the Catholic Church to nuns as "Brides of Christ" illustrates the special status of those who have taken the religious vows of poverty, chastity, and obedience. The courts in the vow of poverty cases thus far have rejected the notion of the vows as resulting in a special status under the civil law. Instead, courts have treated vows of poverty as mere civil agreements. Indeed, in some instances the courts apparently have regarded religious vows as less efficacious for civil law purposes than contracts.¹⁴⁵ This treatment of vows of poverty has led most courts to accept the *Lucas v. Earl* analogy rather than that of *Poe v. Seaborn*.

If on the other hand the courts were to accept the Church's own view of the vow's effect, the *Seaborn* analogy would be more appropriate. The courts are, of course, under no obligation to recognize the Church law in this matter. In instances regarding internal Church property disputes, however, the Supreme Court has held that courts should defer to the Church's own law.¹⁴⁶

The analogy of the vow of poverty situation to the husband's situation in *Seaborn* is powerful if one looks to ecclesiastical law. The parties in *Seaborn* voluntarily entered into a status of marriage, from which flowed certain legal relationships and results. Under the civil law, their income was shared equally by each of them. They could escape this consequence, but only by dissolving the status of marriage or moving to a non-community property jurisdiction. Likewise, when a person takes religious vows that person enters a status from which certain results flow. These results include, among other things, that the religious must obey religious superiors, and that all material goods to which the religious might otherwise become entitled belong to the religious order. The only way to avoid these results is to leave the order. The Church considers both marriage and the religious life to be a status. The Church law defines the status, and as a result of that status (not any voluntary agreement of the parties) consequent rela-

so that their whole existence becomes a continuous worship of God in charity.

§ 2 A religious [order] is a society in which, in accordance with their own law, the members pronounce public vows and live a fraternal life in common. The vows are either perpetual or temporary; if the latter, they are to be renewed when the time elapses.

§ 3 The public witness which religious are to give to Christ and the Church involves that separation from the world which is proper to the character and purpose of each [order].

Id.

145. See *Schuster*, 800 F.2d at 678. In *Schuster*, for example, the appellate court stressed that Sister Francine was free under civil law to leave the Order at any time. *Id.* She was, of course, not free under ecclesiastical law, and even under civil law, if she did leave, would have had no right to her earnings up to the time of her withdrawal. See *id.* at 680-81 (Cudahy, J., dissenting).

146. See, e.g., *Serbian E. Orthodox Diocese v. Milivojevich*, 426 U.S. 696 (1976) (noted in 45 *FORDHAM L. REV.* 992 (1977)); *Presbyterian Church v. Mary Elizabeth Blue Hull Memorial Presbyterian Church*, 393 U.S. 440 (1969); *Gonzalez v. Roman Catholic Archbishop of Manila*, 280 U.S. 1 (1929); *Watson v. Jones*, 80 U.S. (13 Wall.) 679 (1872).

tionships among persons and with respect to property result. If one looks at Church law, therefore, the *Seaborn* analogy is more appropriate than the *Earl* analogy.

It is true that the Church created the religious status and its results while the state created the marital status in *Seaborn*. To this extent *Seaborn* and the vow of poverty situation differ. However, the crucial similarity in both situations is that an institution created a status with consequent results (the Church in one case and the state in the other), and in each case the taxpayer entered that status voluntarily. In *Seaborn* the Court recognized the special legal relationships consequent to that status for tax purposes. In the vow of poverty cases the courts thus far have chosen not to recognize the religious status for tax purposes.

Even if one accepts the application of the *Earl* analogy, the courts apparently have been deciding most cases incorrectly on their facts. In *Schuster*, for example, the Tax Court applying the Commissioner's dubious triangle agency theory, and the Seventh Circuit, applying its flexible test, both basically disregarded the correspondence of the Order's superior with the clinic and the federal government describing the taxpayer as the Order's agent.¹⁴⁷ The courts also disregarded the control that a religious order exercises over its members. The Tax Court and the court of appeals in *Schuster* both gave short shrift to the undisputed fact that Sister Francine was obligated under her vow of obedience to refuse to perform certain duties relating to artificial birth control and did indeed refuse such duties.¹⁴⁸ The Order's control over Sister Francine was certainly greater than the pseudo-control exercised by the taxpayer's personal service corporation in cases such as *Keller v. Commissioner*¹⁴⁹ in which the Tax Court, applying the *Earl* analogy, has recognized the sole shareholder of a personal service corporation as the corporation's agent for purposes of determining to whom income from the shareholder's services was to be taxed.¹⁵⁰

The Court of Appeals in *Schuster*, although it did not cite *Earl*, also misapplied that analogy to the specific facts. Finding the compensation from the clinic to be taxable to Sister Francine, the *Schuster* court cited the following six *Fogarty* factors as being relevant:

147. See *Schuster*, 84 T.C. at 783-84 (Korner, J., dissenting); *Schuster*, 800 F.2d at 682 (Cudahy, J., dissenting); *supra* notes 76-78 (quoting correspondence between clinic and order in *Schuster*).

148. See *Schuster*, 800 F.2d at 682 (Cudahy, J., dissenting).

149. *Keller v. Commissioner*, 77 T.C. 1014 (1981), *aff'd*, 723 F.2d 58 (10th Cir. 1983). See, e.g., *Fox v. Commissioner*, 37 B.T.A. 271 (1938) (recognizing owner of personal service corporation as agent of corporation with result that income from owner's services was taxed to corporation); *Laughton v. Commissioner*, 40 B.T.A. 101 (1939), *rem'd* 113 F.2d 103 (9th Cir. 1940) (same); *Achiro v. Commissioner*, 77 T.C. 881 (1981) (same); *Fatland v. Commissioner*, 53 T.C.M. (P-H) ¶84-489 (1984) (same); *Pacella v. Commissioner*, 78 T.C. 604 (1982) (same). In these cases the control by the corporation over its owner was, of course, merely formal, since the corporation was wholly owned by the service performer, a situation far removed from the relationship of a religious to his or her order.

150. *Keller*, 77 T.C. at 1032.

1) the degree of control exercised by the Order over the member; 2) ownership rights between the member and the Order; 3) the purposes or mission of the Order; 4) the type of work performed by the member vis-a-vis the purposes or mission; 5) the dealings between the member and the third-party employer, including the circumstances surrounding inquiries and interviews, and the control or supervision exercised by the employer; and 6) the dealings between the employer and the Order.¹⁵¹

As to each of these factors the balance tips to the agency status of Sister Francine. The Order exercised complete control over Sister Francine through her vow of obedience. Sister Francine required the Order's permission and acquiescence to continue performing her mission.¹⁵² The Order, even in civil law, was entitled to any compensation that Sister Francine received while she was a member of the Order.¹⁵³ Sister Francine turned all of her compensation over to the Order. The work Sister Francine was performing was precisely within the purposes of the Order to conduct "hospitals and institutions for the care and treatment of suffering humanity."¹⁵⁴ In all dealings with the clinic, Sister Francine's real employer, and the federal government, her employer for payroll purposes, Sister Francine and the Order made her status as the Order's agent absolutely clear. The clinic expressly accepted this status and the federal government never rejected it.¹⁵⁵

Similar facts were present in most of the other cases in which a religious has been held taxable on income despite a bona fide vow of poverty.¹⁵⁶

IV. POLICY REASONS FOR EXCLUSION FROM GROSS INCOME

For most of the federal income tax's history, the Internal Revenue Service followed a policy of allowing the exclusion from gross income of compensation paid to members of religious orders who were under a bona fide vow of poverty.¹⁵⁷ Apparently, the IRS based this policy on the common sense notion that the work performed by members of religious orders was basically the charitable work of the orders themselves. Since the orders were tax exempt, the members performing the order's work also were exempted from tax.

151. *Schuster*, 800 F.2d at 677.

152. *Id.* at 682.

153. *Order of St. Benedict of New Jersey v. Steinhauser*, 234 U.S. 640 (1914).

154. *Schuster*, 800 F.2d at 681 n.5.

155. *Id.* at 682 (Cudahy, J., dissenting).

156. *See, e.g., Fogarty*, 55 A.F.T.R.2d 85-416, 6 Cl. Ct. 612 (1984), *aff'd*, 780 F.2d 1005 (Fed. Cir. 1986); *Hogan*, 57 A.F.T.R.2d 86-338 (D. Me. 1985); *McEneaney*, 55 T.C.M. (P-H) ¶86,413 (1986). In a few instances, courts have found religious taxable because they were no longer living in accordance with their vows of poverty. *See Macior v. Commissioner*, 53 T.C.M. (P-H) ¶84,255 (1984); *Kelley v. Commissioner*, 62 T.C. 131 (1974).

157. *See supra* text accompanying notes 23-35 (discussing Service's vow of poverty policy prior to Revenue Ruling 77-290); *Schuster*, 800 F.2d at 679 (Cudahy, J., dissenting).

Congress, at the very least, acquiesced in this practice. In fact, in a separate but related area, Congress expressly enacted an exemption from taxation. The Internal Revenue Code specifically excludes from the definition of employment for purposes of Federal Insurance Contributions Act (FICA) taxes, "service performed . . . by a member of a religious order in the exercise of duties required by such order. . . ." ¹⁵⁸ This provision was first enacted in 1950. ¹⁵⁹ The legislative history indicates that the exception applied to "the performance of services which are ordinarily the duties of . . . members of religious orders." ¹⁶⁰ Nothing in the legislative history indicates that Congress, in enacting this exemption, intended to restrict the exemption to services performed only directly for the order or the controlling church. ¹⁶¹ Although FICA and the income tax are two separate taxes, at least enough similarity in their bases indicates a Congressional disposition to provide members of religious orders with a broad based exemption from taxation.

Moreover, several published rulings of the Service itself basically are inconsistent with its present position. For example, in Revenue Ruling 74-581, ¹⁶² a university law school's faculty members and students who represented indigents under court appointment as part of the law school's curriculum were not required to include in gross income amounts received and turned over to the university on account of their representation. ¹⁶³ The Service so held, even though in such a situation, the court appoints and the clients deal with the attorney not the university. In another ruling, a police officer received compensation from private employment undertaken as an undercover agent. ¹⁶⁴ The compensation was then turned over to the police department. The Service held that the compensation was not includible in the officer's gross income, even though the private employer could not possibly have been dealing with the police department. ¹⁶⁵

158. I.R.C. § 3121(b)(8)(A). An order can, however, elect to have its members be covered by FICA. I.R.C. § 3121(r). The Treasury regulations elaborate on this statutory exemption as follows:

. . . (d) *Service in the exercise of duties required by a religious order.* Service performed by a member of a religious order in the exercise of duties required by such order includes all duties required of the member by the order. The nature or extent of such service is immaterial so long as it is a service which he is directed or required to perform by his ecclesiastical superiors.

26 C.F.R. § 31.3121(b)(8)-1(d) (1986).

159. Social Security Act Amendments of 1950. Pub. L. No. 81-734, 64 Stat. 477 (1950).

160. S. REP. No. 1669, 81st Cong., 2d Sess. 138, reprinted in 1950-2 C.B. 302, 342; see H.R. REP. No. 1300, 81st Cong., 1st Sess. 130 (1949), reprinted in 1950-2 C.B. 255, 282.

161. See *Samson v. United States*, 743 F.2d 884, 888 (Fed. Cir. 1984) (Friedman, J., dissenting).

162. 1974-2 C.B. 25.

163. *Id.*

164. Rev. Rul. 58-515, 1958-2 C.B. 28.

165. *Id.* Several other rulings have taken similar positions. See, e.g., Rev. Rul. 76-479,

None of these rulings have been revoked or modified by the Service. It is unfair that one set of rules should apply for vow of poverty cases and another set of rules for all other cases. The Service's present stance, however, achieves precisely that result. Furthermore, those rules actually have been changed for religious orders while they have been allowed to remain the same in other contexts.

Regardless of the government's power to change its administrative practices with respect to a particular issue,¹⁶⁶ the unfairness of the Service's abrupt change in the vow of poverty situation is both blatant and patent. Judge Cudahy, in his dissent to the Seventh Circuit's opinion in *Schuster* put it most succinctly:

But here the government has nowhere denied that its change of position was anything but a pusillanimous reaction to the antics of the tax protest movement. Abuse of the tax system by tax resisters, who occasionally have recourse to religious disguises, is no good reason for unfairly changing the rules at the expense of genuine members of religious orders who have taken solemn vows of poverty.¹⁶⁷

If this is true, the problem becomes one of treating fairly taxpayers who have taken bona fide vows of poverty, while at the same time screening out for taxation those who have taken bogus vows.

V. SOME SUGGESTED SOLUTIONS

Taxpayers who use bogus vows of poverty as a ruse to avoid paying taxes should be treated for what they are: frauds. Although the court in *Universal Life Church, Inc. v. United States*¹⁶⁸ indicated a reluctance to judge the validity of the so-called religion in that case,¹⁶⁹ the first amendment

1976-2 C.B. 20 (physician members of nonprofit foundation formed by hospital's medical staff, all of whom were required to be members of foundation, were not required to include in their gross incomes fees from certain patients which they had been required to assign to foundation); Rev. Rul. 65-282, 1965-2 C.B. 21 (checks for statutory legal fees for representing indigent persons received by attorneys and immediately turned over to their employer, legal aid society, not includible in gross incomes of attorneys); Rev. Rul. 58-220, 1958-1 C.B. 26 (checks received by physician and endorsed to hospital of which physician was staff member, not required to be included in gross income).

166. See *Dickman v. Commissioner*, 465 U.S. 330, 343 (1984); *Automobile Club of Michigan v. Commissioner*, 353 U.S. 180, 183-84 (1957).

167. *Schuster*, 800 F.2d at 680 (Cudahy, J., dissenting).

168. 372 F. Supp. 770 (E.D. Cal. 1974).

169. See *id.* at 776. The *Universal Life Church* court expressed the following reluctance to judge the validity of a religion:

Neither this Court, nor any branch of the Government, will consider the merits or fallacies of a religion. Nor will the Court compare the beliefs, dogmas, and practices of a newly organized religion with those of an older, more established religion. Nor will the Court praise or condemn a religion, however excellent or fanatical or preposterous it may seem.

Id.

does not protect alleged religions whose members are without sincerity.¹⁷⁰ Certainly, the government is not without power to make appropriate distinctions in the vow of poverty area based on the sincerity of the taxpayers alleged beliefs.¹⁷¹ What is more fundamental to the existence of orderly government than exercise of the taxing power?¹⁷²

Although the government has in some cases successfully sought civil or criminal fraud penalties, thus far the government has pursued primarily organizers of the fraudulent schemes.¹⁷³ In the run-of-the-mill bogus vow of poverty case, the government has eschewed attacking the bona fides of the vow of poverty, preferring to utilize its agency analysis.¹⁷⁴ The unfortunate result of this strategy has been to sweep up the bona fide vows of poverty along with the bogus ones.

The better resolution would be to return to the pre-Revenue Ruling 77-290 position, excluding from gross income amounts received by persons who have taken and actually are complying with bona fide vows of pov-

170. See *Therault v. Carlson*, 495 F.2d 390, 395 (5th Cir. 1974); *Founding Church of Scientology v. United States*, 409 F.2d 1146, 1162 (D.C. Cir.), cert. denied, 396 U.S. 963 (1969); Worthing, *Religion and Religious Institutions Under the First Amendment*, 7 PEPPERDINE L. REV. 313, 351-52 (1980). The Fifth Circuit in *Therault* has recognized that

[w]hile it is difficult for the courts to establish precise standards by which the bona fides of a religion may be judged, such difficulties have proved to be no hindrance to denials of First Amendment protection to so-called religions which tend to mock established institutions and are obviously shams and absurdities and whose members are patently devoid of religious sincerity.

Therault, 495 F.2d at 395. Similarly, the D.C. Circuit in *Founding Church of Scientology v. United States* found no protection for secular enterprises disguised as a religious organization:

Any prima facie case made out for religious status is subject to contradiction by a showing that the beliefs asserted to be religious are not held in good faith by those asserting them, and that forms of religious organization were erected for the sole purpose of cloaking a secular enterprise with the legal protections of religion.

Founding Church of Scientology v. United States, 409 F.2d 1146, 1162 (D.C. Cir.), cert. denied, 396 U.S. 963 (1969).

171. See *Wisconsin v. Yoder*, 406 U.S. 205, 215-16 (1972). In *Yoder* the Supreme Court noted that

[a]lthough a determination of what is a 'religious' belief or practice entitled to constitutional protection may present a most delicate question, the very concept of ordered liberty precludes allowing every person to make his own standards on matters of conduct in which society as a whole has important interests.

Id.

172. See *Autenreith v. Cullen*, 418 F.2d 586, 589 (9th Cir. 1969), cert. denied 379 U.S. 1036 (1970); *Muste v. Commissioner*, 35 T.C. 913, 920 (1961); *Mail Order Ministries*, *supra* note 37, at 974. Cf. *Braunfield v. Brown*, 366 U.S. 599, 606 (1961) (Court will not strike down tax legislation on first amendment grounds without "the most critical scrutiny").

173. See, e.g., *United States v. Ebner*, 782 F.2d 1120, 1122 (2d Cir. 1986); *United States v. Daly*, 756 F.2d 1076, 1078 (5th Cir. 1985), cert. denied, U.S. (1985).

174. See, e.g., *Teuscher v. Commissioner*, 54 T.C.M. (P-H) ¶85,079 (1985); *Slaughter v. Commissioner*, 52 T.C.M. (P-H) ¶83,502 (1983), *aff'd*, 746 F.2d 1479 (6th Cir. 1984); *Wert v. Commissioner*, 53 T.C.M. (P-H) ¶84-499 (1984); *Brennan v. Commissioner* 53 T.C.M. (P-H) 84-500 (1984); *Kalgaard v. Commissioner*, 53 T.C.M. (P-H) ¶84-283 (1984); *Hall v. Commissioner*, 51 T.C.M. (P-H) ¶82-337 (1982), *aff'd*, 729 F.2d 632 (9th Cir. 1984).

erty.¹⁷⁵ The questions in each case would be whether the vow of poverty is: 1) bona fide; and 2) actually being followed by the religious order member. In most instances this standard would weed out the bogus vows and also those who took bona fide vows but are no longer following them. This standard would result in an intuitively fairer situation than treating taxpayers such as Sister Francine and those in *Ebner*¹⁷⁶ as though their situations were alike.

A. An Alternative Judicial Approach

In the event the approach suggested above is not followed, an alternative judicial approach could be utilized. This alternative judicial approach would continue to allow the individual religious an income exclusion in all cases in which services are performed directly for the religious order itself. However, when services are performed for third parties, the individual religious could exclude payments for those services from income only in cases when the work performed by the religious is within the scope of the activities for which the religious order is granted exemption under IRC section 501(c)(3). Under this alternative judicial approach, the standard is whether the services performed by the religious would be subject to the unrelated business income¹⁷⁷ tax if the services were performed directly by the order. The relevant consideration, therefore, becomes whether the services performed by the religious are "substantially related to the exercise or performance by (the order) of its charitable, educational, or other purpose or function constituting the basis for its exemption."¹⁷⁸

Under the alternative judicial approach, for example, Sister Francine's services for the poor at Su Clinica presumably would not be subject to the unrelated business income tax if the Order owned the clinic and charged a fee for her services. In Father Fogarty's case the question would be whether the unrelated business income tax would apply if the Jesuits operated the school and charged a tuition fee for his classes. The same type of analysis would apply to Father Hogan's and Father McEneaney's duties as hospital chaplains. In all of these cases, the religious under a bona fide vow of poverty would be entitled to exclude the compensation from gross income.

In contrast, the religious in Revenue Ruling 77-290 who secured employment with a private law firm as an attorney would be subject to tax, because if a religious order operated a private law firm, the order, presumably, would be subject to the unrelated business income tax. Religious orders are not granted their exemptions to operate private law firms.¹⁷⁹ By the

175. See *supra* text accompanying notes 23-35 (discussing Service's vow of poverty policy prior to Revenue Ruling 77-290).

176. See *Ebner*, 782 F.2d at 1122.

177. See I.R.C. §§ 511-15.

178. I.R.C. § 513(a).

179. If the religious acted as an attorney for a legal aid clinic this might be considered sufficiently related to a charitable purpose (aiding the poor) to come within the scope of the charitable exemption.

same token, the religious in Revenue Ruling 84-13¹⁸⁰ who operated a private practice as a psychologist would be taxable on the income from that private practice.

Admittedly this alternative judicial approach is not perfect, and difficult cases would remain.¹⁸¹ This approach, however, is better than the Service's and Tax Court's triangle agency theory, and the case-by-case agency analysis that the Federal and Seventh Circuits have undertaken.¹⁸² The former simply represents stretching an analysis appropriate to the personal service corporation situation to fit vows of poverty. The latter case-by-case analysis is inherently uncertain and, judging by the cases decided thus far, extremely difficult to apply.

The suggested judicial approach comports with a common sense¹⁸³ view of the situation. Religious orders are granted tax exemptions because they further certain purposes deemed worthy under the income tax law. When their members engage in activities that further those worthy purposes, the exemption also should extend to the members. If the activities are unrelated to the exempt purposes, the exemption should not apply, just as the exemption does not apply to the unrelated activities of the orders themselves.

The alternative judicial approach would deal effectively with bogus vows of poverty, without questioning the sincerity of the taxpayer's religious beliefs. This approach simply bypasses sensitive first amendment issues. For example, in *McGahan v. Commissioner*,¹⁸⁴ the taxpayer took an alleged vow of poverty assigning his income to his own chapter of the Basic Bible Church.¹⁸⁵ He then continued in his normal occupation as a boilermaker. The court obviously could have challenged the sincerity of the taxpayer's beliefs, and there were, in fact, intimations in the opinion that the court doubted his sincerity. Basing its decision, however, on an agency theory, the *McGahan* court noted that "[t]he income received by him [McGahan] was

180. 1984-1 C.B. 21. In Revenue Ruling 84-13, the religious operated a private psychological practice in which he treated both laymen and clergy for fees. *Id.* The Service held him taxable on these fees on the ground that he was not acting as agent of the Order. *Id.*

181. For example, would the fees earned by the psychologist in Revenue Ruling 84-13, *supra* note 180, for treating clergy be excludible, if such treatment were undertaken under auspices of the local bishop? This possibly could be construed as within the religious purpose exemption.

182. In a recent bogus vow of poverty case, *Mone v. Commissioner*, the Second Circuit apparently applied the triangle agency theory without calling it by that name. *Mone v. Commissioner*, 774 F.2d 570, 573 (2d Cir. 1985). The Second Circuit stated that

[t]o prove assignment of income on an agency theory, the taxpayers bear a double burden: they must show that a contractual relationship existed between their secular employers and the religious order, and that the religious order controlled or restricted the taxpayers' use of the money purportedly turned over to the order.

Id.

183. The author is, of course, well aware that application of this standard may be met with derision in academe.

184. 76 T.C. 470 (1981).

185. Basic Bible Church is a mail order ministry organization controlled by a disbarred attorney. *See United States v. Daly*, 756 F.2d 1076, 1078 (5th Cir. 1985).

not received on behalf of a separate and distinct principal, but was received by him in an individual capacity."¹⁸⁶

Under the alternative judicial approach suggested here, the court also would have found the income includible, since working as a boilermaker in private industry would not be within the exempt purposes of section 501(c)(3). If a religious order operated a factory employing its members as boiler-makers, the order would be subject to unrelated business income tax on its profits from that factory.¹⁸⁷ The vast majority of bogus vow of poverty cases would reach the same result under this line of reasoning. Most of the bona fide vow of poverty cases, however, would result in exclusion from the individual member's gross income under the suggested approach. This alternative judicial approach avoids the counter-intuitive result of treating Sister Francine and the taxpayers in *Ebner* alike.

B. A Statutory Approach

Legislation also might achieve a satisfactory resolution of the issue. In Revenue Ruling 76-323 the Service conceded that when a taxpayer under a valid vow of poverty turned the amounts he received on account of his services over to his tax exempt Order, he would be entitled to a charitable contribution deduction.¹⁸⁸ This offsetting deduction generally will not result in a wash, however, because the amount deductible normally will be limited to 50 percent of the taxpayer's adjusted gross income.¹⁸⁹ The net result, therefore, is that a religious who turns his entire income over to his tax exempt order in accordance with a bona fide vow of poverty will be taxed on half of that income. In several bogus vow of poverty cases, the Service has successfully disallowed an offsetting deduction in full because the purported religious order was not qualified to receive deductible contributions.¹⁹⁰ The most commonly asserted ground for disqualification of the

186. *McGahen*, 76 T.C. at 479-80.

187. See *De La Salle Institute v. United States*, 195 F. Supp. 891, 899 (N.D. Cal. 1961) (unrelated income tax imposed on Christian Brothers' winery operations); *Shiloh Youth Revival Centers v. Commissioner*, 88 T.C. 29 (1987) (unrelated income tax imposed on income of Fundamentalist Christian Communal group from forestry, janitorial, and painting activities); *Whelan*, *supra* note 19, at 911-13.

188. 1976-2 C.B. 18, 19. See also Rev. Rul. 77-436, 1977-2 C.B. 25, 26 (religious order member entitled to charitable contribution for income turned over to tax exempt order).

189. See I.R.C. § 170(b)(1)(A) (generally limiting deduction for charitable contributions to religious organization to 50% of taxpayer's adjusted gross income).

190. See, e.g., *Rager v. Commissioner*, 775 F.2d 1081, 1083 (9th Cir. 1985); *Solander v. Commissioner*, 51 T.C.M. (P-H) ¶82,161 (1982); *Harcourt v. Commissioner*, 51 T.C.M. (P-H) ¶82-621 (1982); *Stephenson v. Commissioner*, 79 T.C. 995 (1982), *aff'd per curiam*, 748 F.2d 331 (6th Cir. 1984); *Pusch v. Commissioner*, 49 T.C.M. (P-H) ¶80,004 (1980); *Manson v. Commissioner*, 49 T.C.M. (P-H) ¶80,315 (1980); *Oakknoll v. Commissioner*, 47 T.C.M. (P-H) ¶78,336 (1978); *Church of the Transfiguring Spirit, Inc. v. Commissioner*, 76 T.C. 1, 5 (1981); *People of God Community v. Commissioner*, 75 T.C. 127, 133 (1980); *Southern Church of Universal Brotherhood Assembled, Inc. v. Commissioner*, 74 T.C. 1223 (1980); *Bubbling Well Church of Universal Love, Inc. v. Commissioner*, 74 T.C. 531, 535-36 (1980); *Western Catholic Church v. Commissioner*, 73 T.C. 196, 199 (1979), *aff'd mem.*, 631 F.2d 736 (7th Cir. 1980), *cert. denied*, 450 U.S. 981 (1981).

“order” is that its net earnings inure to the benefit of a private individual in contravention of IRC section 170(c)(2)(C).¹⁹¹ Thus, the Service and courts apparently are willing and able to distinguish between bogus and bona fide situations when the issue is the qualification of the purported religious order to receive tax deductible charitable contributions.

A statutory resolution of the problem would result if Congress broadened the charitable contribution deduction in appropriate cases. Congress could enact legislation permitting 100 percent deductibility as charitable contributions of amounts turned over to qualified tax exempt organizations by taxpayers in accordance with vows of poverty. The focus in vow of poverty cases would then shift from the nebulous gross income question to the more manageable issue of whether the purported religious order is qualified in fact to receive tax deductible contributions. Under this standard Sister Francine would include the amounts received for her services in gross income, but this inclusion would be offset by a corresponding charitable deduction.¹⁹² The taxpayers in *Ebner* would not be entitled to an offsetting charitable contribution deduction. Their “religious order” would be disqualified from receiving deductible contributions because the earnings of these organizations inure to the benefit of the taxpayers.¹⁹³ This standard would preclude an offsetting deduction in most, if not all, of the bogus vow of poverty cases.

One objection to this proposal is that Congress in the 1969 Tax Reform Act repealed a similar provision on the ground that the provision had been abused.¹⁹⁴ Former IRC section 170(b)(1)(C) (colloquially known as the Philadelphia nun provision) permitted an unlimited charitable deduction to a taxpayer if in eight out of the previous ten years the total of the taxpayer’s charitable contributions plus income taxes exceeded 90% of taxable income.¹⁹⁵ This provision reportedly was enacted to meet the special case of a nun who had inherited trust income in such a form that she was unable to legally divest herself of the right to that income.¹⁹⁶ Several taxpayers

191. See, e.g., *Solander v. Commissioner*, 51 T.C.M. (P-H) ¶82,161; *Harcourt v. Commissioner*, 51 T.C.M. (P-H) ¶82,621 (1982); *Pusch v. Commissioner*, 49 T.C.M. (P-H) ¶80,004 (1980). See also § 501(c)(3) (imposing identical non-inurement requirement for organization to qualify as tax exempt).

192. There would, of course, still be FICA tax consequences since the charitable deduction would not offset the gross income inclusion for FICA purposes.

193. See *United States v. Ebner*, 782 F.2d 1120, 1124 (2d Cir. 1986) (while defendants reported to IRS that they were living under vow of poverty, defendants used church funds to pay for Cadillacs, ocean front homes, and boats).

194. See Tax Reform Act of 1969, Pub. L. No. 91-172, § 201(a), 83 Stat. 487, 551 (1969) (repealing former IRC § 170(b)(1)(C)); H.R. REP. NO. 91-413, 91st Cong., 1st Sess. 52 (1969) [hereinafter H.R. REP. NO. 91-413].

195. See I.R.C. § 170(b)(1)(C) (as in effect prior to the Tax Reform Act of 1969).

196. See 115 CONG. REC. 17,22563 (1969) (remarks of Rep. Mills). Representative Mills made the following remarks to the House of Representatives concerning the Philadelphia nun provision:

Let me tell you about one case that provides a good example on this point. In the 1920’s—and I know there were two Members here then that are here now, and

with incomes in excess of \$1 million utilized the provision to avoid taxes on all or most of their income. As a result Congress repealed the Philadelphia nun provision.¹⁹⁷

This objection could be overcome by drafting the statute narrowly to apply only to members of religious orders who turn amounts received by them over to their order.¹⁹⁸ The exemption from the definition of employment in IRC section 3121(b)(8)(A) is drawn in similarly narrow terms.¹⁹⁹ If this were done with the suggested provision the potential for abuse would be diminished considerably.²⁰⁰

VI. CONCLUSION

The Service's abrupt change in policy toward bona fide vows of poverty in Revenue Ruling 77-290 was both unfair and unnecessary. Decades of settled administrative practice were upset by the Service's "pusillanimous

maybe there are others—a man in Philadelphia died possessed of a great estate. In the process of dividing it among his children, he left a very sizable amount of money to a daughter who had become a Catholic nun pledged by her vows not to have income nor to own property.

The property passed to her in a trust in a form which made it impossible for her to divest herself of the property. As a result the law was changed in order to permit her to give all of the income from this property to the church.

So we passed a provision that became known as the unlimited charitable contribution provision, for her benefit.

Id.

197. H.R. REP. NO. 91-413, *supra* note 194, at 52.

198. See *Walz v. Tax Commission*, 397 U.S. 664 (1970) (upholding constitutionality of religion based exemption from local property tax). To avoid constitutional objections, terms referring to religion in the statute would have to be construed broadly, so as to comply with the interpretation of religion in *Seeger v. United States*. See *Seeger v. United States*, 388 U.S. 163 (1964).

In *Seeger* statutory language required conscientious objection to the military draft to be based upon "religious training and belief" defined as "belief in a relation to a Supreme Being involving duties superior to those arising from any human relation." *Seeger*, 380 U.S. at 173. The court held that a meaningful belief occupying the position of God fulfilled this requirement. *Id.* at 173-80. To confine the term religion only to those religions encompassing theistic beliefs probably would render the statute unconstitutional. See generally Friedlund, *Constitutional Issues in Revoking Religious Tax Exemptions: Church of Scientology of California v. Commissioner*, 37 U. FLA. L. REV. 565 (1985); Freeman, *The Misguided Search for the Constitutional Definition of Religion*, 71 GEO. L. J. 1519 (1983); Worthing, *supra* note 170, at 313; Comment, *Toward a Constitutional Definition of Religion*, 91 HARV. L. REV. 1056 (1978); Whelan, *supra* note 19, at 885; Schwarz, *Limiting Religious Tax Exemptions: When Should the Church Render Unto Caesar?*, 29 U. FLA. L. REV. 50 (1976).

199. See I.R.C. § 3121(b)(8)(A). Section 3121(b)(8)(A) excludes *inter alia* from the definition of employment for purposes of FICA:

service performed by a duly ordained, commissioned, or licensed minister of a church in the exercise of his ministry or by a member of a religious order in the exercise of duties required by such order. . . .

Id.

200. Of course the potential for abuse of any special income tax provision can never be completely eliminated.

reaction”²⁰¹ to bogus vows of poverty. Judicial and legislative approaches can and should be devised to separate for tax purposes the bona fide from the bogus vow of poverty. The tax laws can and should separate the wheat from the chaff.²⁰²

201. *Schuster*, 800 F.2d at 680 (Cudahy, J., dissenting).

202. *See Matthew* 3:12 (Revised Standard Version) (“His winnowing fork is in his hand, and he will clear his threshing floor and gather his wheat into the granary, but the chaff he will burn with unquenchable fire.”).