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Income Tax Aspects of the Vow of Poverty

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COMMENTS

INCOME TAX ASPECTS OF THE VOW OF POVERTY

I. INTRODUCTION

Religious orders, which by their nature are typically under the jurisdiction and control of a church, were present in the United States long before the enactment of the sixteenth amendment which authorized the present federal income tax.[1] The Internal Revenue Code generally defines gross income for individuals and organizations alike as income from whatever source derived.[2] Nevertheless, certain organizations which are tax-exempt are not required to pay tax on their income,[3] unless the income is from a business unrelated to the exempt purposes of that organization.[4] It is typical for many religious orders to require a member to take a vow of poverty.[5] It is also not unusual for a member to be directed by the religious order to perform services for either that same order or some other organization.[6] Because these members are often paid for their services, particularly for services performed for outside organizations, an issue has arisen as to whether a member of a religious order who is compensated for services, but who also, pursuant to a vow of poverty, is required to deliver all such earnings to the order, has income within the meaning of the Code.

Although there is no definitive answer by way of statute or case authority, the evolution of the issue has produced three alternative theories:

(1) The individual member has both income and a charitable contribution.[7] For example, a religious member earning $8,000 annually as a secretary for a third party employer could contribute all his earnings directly to the order but would be limited in the charitable deduction of 50 percent of his adjusted gross income.[8] He would be liable for any remaining tax obligation.

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1. U.S. CONST., amend. XVI.
2. I.R.C. § 61.
3. I.R.C. § 501.
4. I.R.C. §§ 511, 512, 513.
5. *See* text accompanying notes 13-17 *infra*.
6. *See* Rev. Rul. 77-290, 1977-2 C.B. 26; Rev. Rul. 76-323, 1976-2 C.B. 18; Rev. Rul. 68-123, 1968-1 C.B. 35.
7. *See* text accompanying notes 31-41 *infra*.
8. I.R.C. § 170(b)(1)(A), Treas. Reg. 1.170A-8(b) (1972).

(2) The individual has no income because by the vow of proverty and obedience he has made a valid anticipatory assignment of income.[9] A religious nurse qualified for a valid assignment to her order by not participating in the third party contract with the employer hospital and by having no control over the disposition of the income.[10]

(3) The individual member has income only if the compensation is for services he performed which are unrelated to the tax-exempt purposes of the religious order—simply an anology to the unrelated business tax imposed upon tax-exempt organizations.[11] For example, if the religious member belongs to an order whose purpose is teaching or ministering to the sick, and the member works for a school or as a teacher or for a hospital as a nurse, the services for the third party employer are related to the tax-exempt purpose of the order. Consequently, the income will be included in the gross income of the order and not that of the individual member.[12]

Before each of the above three theories is explored in more depth, it is useful by way of backgroud to examine the nature of the vow of poverty and obedience made by a member of a religious order and to survey the treatment of the unrelated business income of tax-exempt organizations.

II. THE VOW OF POVERTY AND TAX-EXEMPT ORGANIZATIONS

A. The Effect of the Religious Vows of Poverty and Obedience.

All Catholic religious members are subject to the Pope as their highest superior.[13] By the vow of obedience, they are bound to obey the Pope and the local official, or in the case of nuns the regular superiors as specified by their order and Canon law.[14]

By the vow of poverty, the member of a religious order promises that whatever he acquires by work or in consideration of his being religious is considered to be acquired for the community.[15] There are two levels of vows—the simple and the solemn vows. One who takes a simple vow of poverty surrenders the independent use of temporal property and while the member may retain technical ownership of the property, he may not act as owner because, by the vow, he cannot use what he

9. *See* text accompanying notes 42-88 *infra*.
10. Rev. Rul. 68-123, 1968-1 C.B. 35, 36.
11. *See* text accompanying notes 89-118 *infra*.
12. *Id.*
13. 1 S. WOYWOOD, A PRACTICAL COMMENTARY ON THE CODE OF CANON LAW 184 (4th ed. 1932).
14. *Id.* at 185-86.
15. WOYWOOD, *supra* note 10, at 239 (citing Canon 580 §§ 1-2).

owns as he wishes.[16] After a solemn vow, Canon law provides that goods which that individual receives accrue either to (1) the order or province, or (2) the Pope.[17]

Tax issues arise when religious members, who are subject to the vows of poverty and obedience and, thus, without total control over the receipt or disposition of their income, are directed by their religious order to accept employment with third parties. For example, a religious nurse may be ordered to work at a particular hospital or a priest attorney may be instructed to become a member of a law firm. If the religious member must include such earnings in his income, he will have to receive funds from the religious order to pay any tax liability because by his vow of poverty he has surrendered his personal use of money. One way to prevent this situation would be for the earnings of the religious member to be considered earnings of the religious order.

B. The Unrelated Business Income of a Tax-Exempt Organization.

Once the organization is granted tax-exempt status,[18] all income related to the tax-exempt purpose including amounts received through

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16. H. PAPI, RELIGIOUS IN CHURCH LAW 236 (1924). A vow of poverty by the Dominican Order states as follows:

> First: Do hereby renounce all temporal goods that I am now actually possessed or seized of (in the certain hope of acquiring) which consists of all natural rights of inheritance and cede them . . . .
>
> Second: Do hereby declare that by the act of making my solemn profession, I do render myself incapable of possessing temporal goods as my own or of using them with a private right, so that any contrary act, i.e., any act of receiving, retaining, selling, giving, exchanging, profiting, etc., on my own authority is an act that is null and void.
>
> Third: Do declare that after solemn profession all goods which may in any way accrue to me individually belong to the order to be given to the Province or to the Convent in accordance with the Constitution of the Dominican Order.

Kelley v. Comm'r, 62 T.C. 131, 132 (1974).

17. WOYWOOD, *supra* note 10, at 240 (citing Canon 582).

18. Most churches and religious organizations qualify for exemption of federal income tax under section 501(a) of the Internal Revenue Code. Schwarz, *Limiting Religious Tax Exemptions: When Should the Church Render Unto Caesar?*, 29 U. FLA. L. REV. 50, 52 (1976). Section 501(a) allows tax exempt status to those organizations described in 501(c)(3) as "any . . . foundation, organized and operated exclusively for religious, charitable, scientific, testing for public safety, literary, or educational purposes." I.R.C. § 501(c)(3). This section of the Code does not use the word "church" as such but rather the term "religious." Thus, in order to understand how a church qualifies for tax-exempt status it is necessary to determine what organizations are "religious."

> Given the diversity of religious activities and beliefs, and the structural diversity of churches and their related auxiliaries, these definitions inevitably raise sensitive issues of classification. They also provide a threshold opportunity for tax authorities and courts to limit the availability of tax benefits by concluding that an organization has failed to come within the parameters of the pertinent statutory language.

religious members who assign their income to the religious organization is excluded from the organization's gross income. The Tax Reform Act of 1969 extended the unrelated business tax[19] to all section 501(c) organizations including churches.[20] Under the Code a tax-exempt organization may direct or own an unrelated trade or business and still retain its exempt status. The income from the unrelated business, however, will be taxable income to the organization. If the operation of an unrelated trade or business becomes its primary purpose, a section 501(c)(3) organization will lose its exemption and be required to include all its income in taxable gross income.[21] The regulations set

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Schwarz, *supra* at 58.

"Charitable" has often been regarded as the most significant generic term in section 501(c)(3) because religious and educational purposes must also be charitable to qualify for tax exemption. Green v. Connally, 330 F. Supp. 1150, 1157-61 (D.D.C.), *aff'd sub nom.* Coit v. Green, 404 U.S. 997 (1971); Rev. Rul. 67-325, 1967-2 C.B. 113, 116. The regulations provide that "charity" is to be defined broadly in its "generally accepted legal sense" and not limited by other tax exempt purposes in section 501(c)(3) which "may fall within the broad outlines of 'charity.'" Treas. Reg. § 1.501(c)(3)-1(d)(2) (1976). This liberal construction of "charitable" includes, but is not limited to, relief to the poor, advancement of religion, and promoting the social welfare, which are purposes an organization can ordinarily demonstrate with little difficulty. *Id.*

To determine if the taxpayer organization is tax-exempt not only as a charity but also as a religious organization, its activities must be for "exclusively . . . religious . . . purposes." I.R.C. § 501(c)(3). The term "religious" is used in various other Code sections besides section 501(c)(3) but has never been defined by either the Code or regulations. Whelan, *"Church" in the Internal Revenue Code: The Definitional Problems,* 45 FORDHAM L. REV. 885, 886 n.7 (1977). Other sections in the I.R.C. using the word "religious" include §§ 170(c)(2)(B); 642(c)(2); 2055(a)(2); 512(b)(12); and 6033(a)(2)(A)(iii). *Id.* at 887-88 nn.11-24. In United States v. Ballard, 322 U.S. 78 (1944), the Supreme Court, hearing a mail fraud prosecution by the religious sect "I Am" movement, expressed the view that any inquiry into an organization's religious beliefs to determine if it qualifies as "religious" should be minimal.

> The religious views espoused by respondents might seem incredible, if not preposterous, to most people. But if those doctrines are subject to trial before a jury charged with finding their truth or falsity, then the same can be done with the religious beliefs of any sect. When the triers of fact undertake that task, they enter a forbidden domain.

Id. at 87. Later, the Supreme Court in United States v. Seegar, 380 U.S. 163 (1965), stated that its task was only to decide if the beliefs held were sincere and, in the member's own scheme of things, religious. *Id.* at 176. The Court added that beliefs would not be considered "religious" if based solely on political, sociological, or philosophical views. *Id.* at 173. Thus, by these standards even the most unorthodox organizations may qualify as "religious."

19. Broadly it can be defined as a tax on any activity not exclusively for the tax-exempt purpose of the I.R.C. § 501(c) organization. I.R.C. §§ 511, 512, 513.

20. I.R.C. § 513(a)(2); Treas. Reg. § 1.513-1(a) (1975); Whelan, *supra* note 18, at 892. Due to abuses by churches exploiting their favored status by excessive commercial activity, the National Council of Churches and the United States Catholic Conference urged Congress to eliminate the church exemption. Schwartz, *supra* note 18, at 95.

21. Schwarz, *supra* note 18, at 93.

forth the test to determine if the income is unrelated: "(1) it is income from trade or business, (2) such trade or business is regularly carried on by the organization, and (3) the conduct of such trade or business is not substantially related (other than through production of funds) to the organization's performance of its exempt functions."[22]

Section 513(c) states that for purposes of this section a "'trade or business' includes any activity which is carried on for the production of income from the sale of goods or the performance of services."[23] According to the regulations, the phrase "regularly carried on" is to be determined by the frequence, continuity, and manner with which the income producing activities are pursued.[24] The regulations also state that a trade or business is "substantially related" for purposes of section 513 only if the causal relationship to the achievement of exempt purposes is a substantial one.[25]

In *DeLaSalle Institute v. United States,*[26] a California district court determined the commercial wine business of the Christian Brothers to be an unrelated business.[27] The court determined that since the members of the order were neither priests nor engaged in worship services, the order could not qualify as a tax-exempt organization because education and wine making are not church functions within the Internal Revenue Code.[28] This decision supports the language of the Code which limits the mandatory exemption filing requirement to "churches, their integrated auxiliaries" or "the exclusively religious activities of any religious order."[29] The criteria for determining unrelated business income of tax-exempt organizations are analogous to those

22. Treas. Reg. § 1.513-1(a)(1975).

23. I.R.C. § 513(c).

24. Treas. Reg. § 1.513-1(c) (1975). "Hence, for example, specific business activities of an exempt organization will ordinarily be deemed to be 'regularly carried on' if they manifest a frequency and continuity, and are pursued in a manner, generally similar to comparable commercial activities of non-exempt organization." *Id.*

25. Treas. Reg. § 1.513-1(d)(2) (1975). "Whether activities productive of gross income contribute importantly to the accomplishment of any purpose for which an organization is granted exemption depends in each case upon the facts and circumstances involved." *Id.*

26. 195 F. Supp. 891 (N.D. Cal. 1961).

27. *Id.* at 900-03. *See also* Garland & Cahill, *The Concept of Church in the 1954 Internal Revenue Code*, 1 CATH. LAW. 27 (1955).

28. *Id.* In Parker v. Comm'r, 365 F.2d 792 (8th Cir. 1966), *cert. denied* 385 U.S. 1026, the Eighth Circuit held that the Foundation of Divine Meditation had unrelated business income by publishing and commercially capitalizing upon the writing of its founder. But the court did distinguish this exploitation from the typical sale of pamphlets or newsletters by religious organizations. *Id.* at 798.

29. I.R.C. § 6033(a)(2)(A)(i), (iii). Without the mandatory exemption provided by § 6033(a)(2)(A), a religious organization must file a return and is liable for any tax on unrelated business income as prescribed in I.R.C. § 511.

used in recent revenue rulings treating the issue of whether a religious member, under the vow of poverty, must include in his own income amounts received and assigned to the religious order.[30]

III. TAX TREATMENT THEORIES FOR COMPENSATION PAID TO A MEMBER OF A RELIGIOUS ORDER

A. Inclusion in Income and Charitable Deduction

The general rule of tax law defines gross income as "all income from whatever source derived"[31] except as specifically excluded.[32] In *Commissioner v. Glenshaw Glass*,[33] the Court gave a broad interpretation to the definition of gross income in the Code stating that a more narrow interpretation "would do violence to the plain meaning of the statute and restrict a clear legislative attempt to bring the taxing power to bear upon all receipts constitutionally taxable."[34]

The regulations provide that gross income includes income realized by cash, property, or services.[35] Based upon the statute and the regulations, the religious member would seem to be required to include his earnings in gross income. Under this theory, the religious member may diminish his tax liability created by the inclusion in income by taking a charitable contribution deduction for the earnings given to the religious order.[36] This recognition of income and a corresponding charitable deduction is the minimum treatment to which all members of a religious order are entitled.

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30. *See* text accompanying notes 65-118 *infra*.
31. I.R.C. § 61(a).
32. I.R.C. §§ 61(b), 101-24.
33. 348 U.S. 426 (1955).
34. *Id.* at 432-33.
35. Treas. Reg. § 1.61-1(a) (1960).
36. I.R.C. §§ 170(a)(1), 170(c). But the deduction may not fully offset the income. The Code defines charitable contributions to include a contribution or gift to a foundation "organized and operated exclusively for religious . . . purposes." I.R.C. § 170(c)(2)(B). Under the cash equivalent theory of gross income, the value to the member of the clothing, food, and housing he received from his order would be included in his gross income without any offsetting charitable deduction. Treas. Reg. § 1.61-2d. Additionally the taxpayer would be liable to include in gross income the social security contributions and withholding of tax by the employer. Rev. Rul. 79-49, I.R.B. 1979-7, 6. If the member receives income in the form of support, then his total income would be receipts from third parties plus the value of support. He is entitled to a charitable deduction of 50% of that amount. Consequently, if he gives all of his income to the order he would now be permitted to deduct a larger portion of it: 50% × (cash income + support) > 50% × cash income. If he pays for his own support out of his cash income as in Rev. Rul. 76-323 his income would not be increased by any receipt of support and his deduction for his contribution, because of the 50% limit, would not be reduced either so long as he gave at least half his income to the order. See Treas. Reg. §1.501(d)-1 for tax treatment of income received by religious corporation whose individual members must include the earnings in their own gross income as dividends received.

The charitable contribution section, however, limits the amount of the deduction for a contribution to a charitable organization depending on the form of the contribution. Thus, if a religious lawyer donated his total gross income directly to a religious order, which is considered an integrated auxiliary of the church,[37] his deduction is limited to 50 percent of his contribution base.[38] By making the gift merely for the use of the order or in the form of a capital gain property, the taxpayer is limited to a 20 or 30 percent deduction.[39] He is allowed no deduction for the value of any services donated to the religious order.[40] But by the vow of poverty, the religious member has voluntarily surrendered control over the receipt or disposition of his earnings so that the order would have to pay any remaining tax liability owed by the member.[41] The preferable solution would be for the IRS to recognize the member's assignment of his earnings to the religious order so that the amount would be included in the gross income of the order.

B. Assignment of Income to the Religious Order.

1. Assignment of Income Generally.

The doctrine of anticipatory assignment of income[42] is one instance in which the Code is so general that the resulting corpus of case law amounts nearly to a common law of taxation.[43] The most significant

37. I.R.C. § 501(h)(5)(B).

38. I.R.C. § 170(b)(1)(A), Treas. Reg. 1.170A-8(b) (1972). The contribution "directly to" (not merely for the use of) a church or religious order is limited to 50 percent of his contribution base. Contribution base means adjusted gross income without regard to operating loss carryback. I.R.C. §§ 172, 170(b)(1)(E). Under the original 1954 Code, § 170(b)(1)(C) permitted an unlimited charitable deduction for certain individuals which could have been helpful to religious members under the vow of poverty. Having been amended by § 201(a)(1)(B) of the Tax Reform Act of 1969, it was ultimately repealed by § 1901(a)(28)(A) of the Tax Reform Act of 1976. See J. MERTENS, JR., LAW OF FEDERAL INCOME TAXATION, § 170(b)(1)(C) 1954-1958 Code (1959), 1976 Code (1976).

39. Treas. Reg. §§ 1.170A-8(d)(1) (1972), 1.170A-8(c) (1972). An individual who contributes appreciated capital gain property may deduct up to 30 percent of his contribution base taking into account first all other charitable contributions made during the year. A 20 percent limitation on the deduction from the contribution base is placed upon one who donates "for the use of" any section 170(c) organization.

40. Treas. Reg. § 1.170A-1(g) (1975). If an individual donates his services he may deduct the expenses which he says are "incident to" the service.

41. Under the rationale of Old Colony Trust v. Comm'r, 279 U.S. 716 (1929), the taxpayer member would also have to include in gross income the amount of the tax paid by the order. See, Rev. Rul. 79-49, I.R.B. 1979-7, 6.

42. An anticipatory assignment of income is the shifting or assigning of the right to receive income to another and may be in the form of contracts or rights to receive salary. It may be induced by tax avoidance motives. See 2 J. MERTENS, JR., LAW OF FEDERAL INCOME TAXATION §§ 18.01, 18.02 (rev. ed. 1975).

43. *Id.*

judicial decision in antcipatory assignment of income doctrine is *Lucas v. Earl*.[44] In *Earl*, the taxpayer contended that a contract by which he assigned a part of his future income from personal service to his wife was sufficient to shift the income and tax to her.[45] The much-quoted opinion by Justice Holmes refused to countenance "anticipatory arrangements and contracts however skillfully devised . . . by which the fruits are attributed to a different tree from that on which they grew."[46]

A decade later, the Supreme Court decided in *Helvering v. Horst*[47] that a father could not shift the tax on bond interest by detaching an interest coupon before its due date and giving it to his son.[48] Enlarging upon the *Lucas v. Earl* doctrine, the Court stated the purpose of tax law to be "taxation of income to those who earn or otherwise create the right to receive it and enjoy the benefit of it when paid."[49]

In *Harrison v. Schaffner*,[50] the Court addressed an anticipatory assignment of trust income, and restated the general rule that "one vested with the right to receive income did not escape the tax by any kind of anticipatory arrangement, . . . since, by the exercise of his power to command the income, he enjoys the benefit of the income on which the tax is laid."[51]

The Tax Court in 1974 decided *Kelley v. Commissioner*[52] dealing with an assignment of income by a member of a religious order to the organization. The taxpayer was a Dominican priest who had been living outside the order for several years, yet contended the income he earned in several secular positions was not includible in his gross income since he was acting as an agent of the order.[53] The taxpayer priest breached his vows of poverty and obedience by having the complete control over the receipt and disposition of his income and by marrying without the permission of the order.[54] The Court held that, because the priest was not fulfilling any duties required by the religious

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44. 281 U.S. 111 (1930).
45. *Id.* at 113-14.
46. *Id.* at 115. The decision did not consider tax avoidance motives because the contract predated the enactment of the income tax. *See* C. Lyon and S. Eustice, *Assignment of Income: Fruit and Tree as Irrigated by the P.G. Lake Case*, 17 TAX. LAW. REV. 296, 296-301 (1962).
47. 311 U.S. 112 (1940).
48. *Id.* at 117.
49. *Id.* at 119.
50. 312 U.S. 579 (1941).
51. *Id.* at 582.
52. 62 T.C. 131 (1974).
53. *Id.*
54. *Id.* at 135-38.

order nor restricted in the receipt or disposition of his earnings, his vows of poverty and obedience lacked substance as a practical matter.[55] He could not be deemed an agent of his order, but rather had received the income as an individual.[56]

The *Kelley* court followed the test set forth in *Schaffner,*[57] reasoning that because the priest was the one vested with the right to receive income and because he had command over the income enabling him to enjoy its benefits, it was includible in his gross income. Thus, an anticipatory assignment of income will not avoid tax liability when the assignor retains a vested right and control over the property or "tree."

2. Assignment of Income to a Charity.

The regulations provide that if services are directly and gratuitously rendered in kind directly to a charitable organization, no amount is includible in the income of the person performing the service.[58] If, however, the person performs a service for a third party and directs that the third party make payment to the charitable organization, the amount of the earnings is includible in the gross income of the performer of the service.[59] In a 1953 Revenue Ruling, the IRS took the position that failure to include the earnings in the income of the individual rendering the services would result in allowing the taxpayer "to avoid the percentage limitation on the deduction of charitable contributions."[60]

Yet, the IRS did state that there would be an exception to its present rule,

> If the individual does not participate directly or indirectly in the contract pursuant to which his services are made available to the third party and if he has no right to receive, or direct the use or disposition of, the amounts so paid, such amounts are not includible in his gross income.[61]

Additionally the taxpayer rendering the service must show good faith and the lack of a tax avoidance purpose behind the contractual relationship and that the "organization is entitled, in substance as well as form, to the services made to the third party."[62] The IRS suggested

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55. *Id.*
56. *Id.*
57. 312 U.S. 579 (1941).
58. Treas. Reg. 1.61-2(c) (1966).
59. *Id.* Of course, the same amount is deemed to have been contributed to the charity.
60. Rev. Rul. 71, 1953-1 C.B. 18.
61. *Id.* at 19.
62. *Id.*

that these conditions would be met if the individual's services, as an incident to his normal employment duties, are made available to a third party by the employer with payment made directly to the employer.[63]

For example, a religious member who normally cooks and plans meals for members of the order may be placed by the order through a third party contract in a secular organization to provide the same service. If the member had no part in the contract and no control over the receipt or disposition of the income, the member would fulfill the criteria of the 1953 Revenue Ruling. Clearly, the Dominican priest in the *Kelley* case would not meet the standards for the exception to the assignment rule. *Kelley* entered into his own contracts of employment, received and directed the use of his earnings and would probably be unable to show good faith and lack of tax avoidance motives.[64] But a religious member clearly faithful to his vows of poverty and obedience who is directed by the order to perform services for a third party of the type he normally performs and who will have no control over the amounts paid fulfills the requirements stated in the 1953 Ruling.

3. Receipt of Income as Agent for an Employer or Religious Order.

The first revenue ruling on the inclusion of income by a member of a religious order was O.D. 119[65] which stated that members must include in gross income any earnings received by them individually but that they are not required to include income received as agents of the order.[66] In order to discover who is deemed an agent of an order, it is helpful to examine the regulations, the case law on assignment of income, and the revenue rulings on assignments by religious members and by those in other occupations and professions.

The general rule is that income received by an agent acting on behalf of a principal is includible in the gross income of the principal.[67] In Revenue Ruling 68-123, a religious nurse was required by the religious order to serve as a nurse at a local hospital.[68] In this ruling, the service took a broad view of the relationship between the member's duties and the purpose of the religious order by stating the purpose was "to provide personnel to missions, hospitals, schools, and social work agencies."[69] The IRS did not examine the exact nature and extent

63. *Id.*

64. 62 T.C. 131 (1974).

65. O.D. 119, 1 C.B. 82 (1919). This was superceded in Rev. Rul. 77-290, 1977-2 C.B. 26, as discussed in text accompanying notes 111-18 *infra*.

66. *Id.*

67. Rev. Rul. 68-123, 1968-1 C.B. 35.

68. *Id.*

69. *Id.* This broad view of the term "service" would accord with the Treas. Reg. § 31.3401(a)(9)(d) (1960) that the nature or extent of services is immaterial if the member

of the work performed by the nurse.[70] Rather, citing the 1953 Revenue Ruling, the IRS maintained that the earnings would not be included in the religious nurse's income because: (1) she did not participate directly or indirectly in the third party contract, (2) due to her vows of obedience she could assert no control over her employment without being dismissed from the order, (3) the order had requested the checks but the hospital gave them to the religious nurse who endorsed them directly to the order, (4) she had no right of control over the income, and (5) the services were incident to her normal obligations and duties and were entered into in good faith.[71]

By comparison, revenue rulings on anticipatory assignments by physicians,[72] lawyers,[73] and police officers[74] to their employer do not consider the nature and extent of the services but rather concentrate on the control over the receipt and disposition of the income and the mandatory character of the performances.[75] In Revenue Ruling 76-479, all members of a non-profit hospital were required to provide medical care to low income patients.[76] Prior to treating the patients, the staff members assigned all fees received to the hospital foundation.[77] The IRS stated that as a general rule earnings are included in the employee's gross income,[78] but it distinguished this particular fact situation on the basis that the staff members had "no control over the fees charged, or the collection and disbursement of such fees."[79] Thus the members were deemed to receive the payments as agents of the foundation, not as individuals. Similarly, in Revenue Ruling 58-220,[80] physicians appointed on a full-time salary basis to a hospital but who frequently received checks from patients for services rendered were not required to include the checks in gross income.[81] The IRS focused

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is required by his superiors to perform it. This regulation determines whether the employer must make a social security contribution and withhold income tax for the employee.

70. Rev. Rul. 68-123, 1968-1 C.B. 35, 36.

71. *Id.*

72. Rev. Rul. 76-479, 1976-2 C.B. 20; Rev. Rul. 58-220, 1958-1 C.B. 26; Rev. Rul. 69-274, 1969-1 C.B. 36.

73. Rev. Rul. 65-282, 1965-2 C.B. 21.

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

75. *See* notes 95-96 *infra.* Nevertheless, the nature of services performed by these physicians and lawyers for the third parties was of the same type owed to their principal employer, namely medical or legal services. The services were, therefore, not unrelated to their normal employment.

76. Rev. Rul. 76-479, 1976 C.B. 20.

77. *Id.*

78. *Id.* See text accompanying notes 31-40 *supra.*

79. *Id.* at 21.

80. Rev. Rul. 58-220, 1958-1 C.B. 26.

81. *Id.*

upon the taxpayers' lack of control over the fees, stating the physicians were merely conduits to the hospital for the fees collected.[82]

According to Revenue Ruling 65-282,[83] attorneys employed by a legal aid society need not include fees received from clients in their gross income if the checks are immediately endorsed and given to the society.[84] The IRS determined the attorneys are agents of the legal aid society because they receive no benefits from the receipt of the fees.[85] Finally, in Revenue Ruling 58-515,[86] the IRS determined that an undercover police officer who enters into his own third party contract as required by his police department and who still receives his salary from the police department while remitting all earnings from the third party contract to the police department need not include the third party earnings in his gross income.[87] The IRS decided the police officer receives the money as an agent of the police department because he was required to seek the employment and remitted all earnings.[88]

C. Income from Activities "Unrelated" to Purpose of the Religious Order.

In Revenue Ruling 77-290[89] an attorney priest was required to seek third party employment at a law firm with the firm paying all his earnings directly to the religious order.[90] The order then paid the priest's living expense.[91] The IRS determined the earnings were includible in the priest's gross income, focusing not upon the control of the income but on the relatedness of the duty to the tax-exempt purpose of the organization.[92] The difference in results from Revenue Ruling 58-515[93] is difficult to justify by any factual distinction between the two situations. Although the policeman in Revenue Ruling 58-515 entered into a legal contract with his principal to assign his earnings from his undercover job, the priest's vows of poverty and obedience were an even more fundamental and encompassing contract because they bound the priest not only legally but also morally and psychologically.[94] He could

82. *Id.*
83. Rev. Rul. 65-282, 1965-2 C.B. 21.
84. *Id.*
85. *Id.*
86. Rev. Rul. 58-515, 1958-2 C.B. 28.
87. *Id.*
88. *Id.*
89. Rev. Rul. 77-290, 1977-2 C.B. 26.
90. *Id.*
91. *Id.*
92. *Id.* But this does not affect the tax-exempt status of the organization.
93. Rev. Rul. 58-515, 1958-2 C.B. 28.
94. Rev. Rul. 77-290, 1977-2 C.B. 26.

reasonably argue that the employment contract with the law firm is a mere formality which represents no effective control by him over the disposition and enjoyment of his income.

Another recent revenue ruling also rejects the validity of attempted assignments by religious members. In Revenue Ruling 76-323, two religious members were required by the order to secure outside employment.[95] One worked as a plumber; the other worked as a carpenter.[96] They received their earnings, paid their living expenses, and remitted the rest to the order. They had to account to the order for all sums received and paid. The income was held to be includible in the members' gross incomes.[97]

The IRS determined that under the general rule of *Earl,* the taxpayers could not avoid inclusion of the earnings in their gross income or avoid payment of social security contributions by an anticipatory assignment of income.[98] The IRS did not base its determination upon the standards for a charitable assignment it had previously set out in its 1953 Ruling.[99] Rather, it relied upon the nature and extent of the services performed by the member.[100] The IRS concluded that for the assignment of income to be valid, the duties must (1) be ordinarily the duties of the order and (2) be performed on behalf of the order by the member as an agent.[101] Additionally, the IRS stated that to determine if the duties are ordinarily the duties of the order, the government must look to see if they are related to its established activities. A member is to be deemed an agent only if the order is a principal, but an order is not a principal where there is a third party contract between the member and the third party.[102] This standard in recent revenue rulings is far more restrictive than the requirement in the 1953 Revenue Ruling that the services of the member be incident to his normal employment duties.[103] It is possible that both plumbing and carpentry could be normal duties of specific religious members within the religious community.

The IRS's concern with relatedness of the duties to the established activities of the order is similar to the "relatedness" and "regularly carried on" test of unrelated business income,[104] even though the IRS

95. Rev. Rul. 76-323, 1976-2 C.B. 18.
96. *Id.*
97. *Id.*
98. *Id.* Lucas v. Earl, 281 U.S. 111 (1930).
99. *See* text accompanying notes 57-63 *supra*.
100. Rev. Rul. 76-323, 1976-2 C.B. 18, 19.
101. *Id.*
102. *Id.*
103. Rev. Rul. 71, 1953-1 C.B. 18.
104. *Id. See* text accompanying notes 57-63 *supra*.

does not draw that comparison itself. Under this reasoning, carpentry and plumbing cannot be regarded as substantially related to the exempt purpose of the organization. But even if the IRS had used the standards set forth in the 1953 Revenue Ruling,[105] the result would likely have been the same. Earnings from plumbing and carpentry would have been included in the gross income of the member due to two factors: (1) the member directly entered into his own employment contract, and (2) the member had the right to receive and direct the use of the income for living expenses.[106]

Recent revenue rulings also consider whether the employer must withhold income tax and social security contributions based upon the determination of whether there is a valid assignment of income to the order.[107] The Code specifically exempts an employer from the duty to withhold income tax from remuneration paid to "a member of a religious organization in the exercise of duties required by such order."[108] The regulations governing both income tax withholding and social security contributions add that "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."[109] Yet despite its regulations stating that the nature of a service is immaterial, the IRS is examining the type of the service to decide the validity of the assignment and then making the employer of a religious member, whose assignment to the order is not valid, liable for withholding tax and social security contributions.[110]

Revenue Ruling 77-290 clarified the carpentry-plumbing Revenue Ruling 76-323 and superseded O.D. 119[111], the original ruling on a religious member as agent of his order. At issue was the assignment of income by a religous attorney and a religious secretary ordered by their superiors to take certain employment.[112] The attorney was specifically instructed to work as an employee of a law firm and the secretary to accept salaried employment with the business office of the church. The IRS stated the general rule that an anticipatory assignment will not

105. *Id.*
106. Rev. Rul. 76-323, 1976-2 C.B. 18.
107. Rev. Rul. 76-323, 1976-2 C.B. 18, 19; Rev. Rul. 77-290, 1977-2 C.B. 26, 27.
108. I.R.C. § 3401(a)(9). This section does not exempt such remuneration from gross income but merely governs withholding requirements.
109. Treas. Regs. §§ 31.3401(a)(9)-1(d) (1960); 31.3121(b)(8)-1. See Rev. Rul. 58-229, 1958-1 C.B. 331; Rev. Rul. 71-7, 1977-1 C.B. 282; Rev. Rul. 71-258, 1977-1 C.B. 283.
110. Rev. Rul. 76-323, 1976-2 C.B. 18, 19; Rev. Rul. 77-290, 1977-2 C.B. 26, 27. See I.R.C. §§ 3121(b)(8)(A), 1402(e), 3401(a)(9).
111. Rev. Rul. 77-290, 1977-2 C.B. 26.
112. *Id.*

shift the tax liability, but it also recognized that income received under the vow of poverty and as an agent of an order is the income of the order.[113]

Once again the determination was based upon whether the duty was ordinarily required of a religious member and whether the order was the contracting principal.[114] The IRS determined that the secretary need not include her earning in gross income nor was she subject to withholding or social security contributions because by working for an associated branch of the church she remained an agent of her order.[115] But the IRS stated the attorney had tax on gross income because his particular legal services were not of a "type ordinarily required to be performed by members of the religious order."[116] The attorney was consequently held to be an agent of the law firm rather than his order and the law firm was required to withhold income tax from his wages and make social security contributions.[117]

The test used by the IRS may derive strength from analogy to that used to determine the unrelated business income for the tax-exempt organization. The religious secretary's employment was related to the exempt function of a church agency. The attorney's duties were not "ordinarily required" or substantially related to the order's exempt business.[118]

IV. CONCLUSION

The general rule of anticipatory assignment of income, articulated by Mr. Justice Holmes, prevents a taxpayer from escaping tax liability by assigning the income and tax burden to another.[119] Later, in *Harrison v. Schaffner*,[120] the Court held that one vested with the right to receive income did not avoid tax liability by an assignment since in making the disposition, he exercised control over and received a benefit from the income.[121] This doctrine was again endorsed in the

113. *Id.* (citing Rev. Rul. 76-323, 1976-2 C.B. 18).
114. Rev. Rul. 77-290, 1977-2 C.B. 26, 27.
115. *Id.*
116. *Id.*
117. *Id.* But the comparison to the treatment of the unrelated business income of tax-exempt organizations breaks down. When a tax-exempt organization operates a business unrelated to its exempt purpose, the income from that business is taxable but it is still the income of the exempt organization. On the other hand, the IRS's rulings hold that where the members of a religious order earn income in duties unrelated to the purpose of the religious order the income is taxable—but to the religious member and not to the order.
118. *Id.*
119. Lucas v. Earl, 281 U.S. 111 (1930).
120. 312 U.S. 579 (1941).
121. *Id.*

1953 Revenue Ruling dealing with assignment of services to a charity.[122] But the IRS determined that the income would not be includible in gross income of the person performing the service provided (1) the taxpayer has no control over the receipt and disposition of the income, (2) there is no direct participation in the contract with the third party, (3) the assignment is made in good faith and without a tax avoidance motive, and (4) the services performed are the kind to which the organization is entitled from the taxpayer.[123]

To use the standard applied in later Revenue Rulings 76-323 and 77-290 is to leave the traditional standards for determining a valid anticipatory assignment and focus upon a definition of related duty that can seemingly only be supported by analogy to the section 501(c) unrelated business income standards of "relatedness."[124] It should be noted that revenue rulings only represent the position of the IRS on a given fact situation and that they do not bind the courts.[125] There is no Code section or case law which explicitly provides support for the approach of the revenue rulings. To follow the most recent rulings of the IRS places little relevance upon the strength of the moral contractual obligation existing between the religious member and the religious order by virtue of his vows of poverty and obedience. Although the vows are voluntarily taken, once they are made they bind the member to obedience to his superiors and transfer to the order any rights to the receipt and disposition of any income earned as a member. This control over income and the disposition of its benefits has been a fundamental criteria since *Harrison v. Schaffner*[127] in 1941 and should not now be superceded by a relatedness of duty test which has no case or Code support.

Meanwhile, members of religious orders are least likely to be taxed individually by the IRS if they adhere to the guidelines of the 1953 Revenue Ruling: (1) The employment contract of the religious member with the third party should be directly between the religious order and the third party. (2) All payments for religious members' services should be made to the order directly by the third party. (3) The order should be ready to argue that the arrangement was made for good faith reasons and not just tax avoidance motives. (4) The services provided

122. Rev. Rul. 71, C.B. 1953-1, 18.
123. *Id.*
124. *See* text accompanying notes 18-30 *supra*.
125. They are an indication, however, that the taxpayer must be prepared to litigate the matter if he wants different tax treatment in the same type of situation.
126. *See* text accompanying notes 13-17 *supra*.
127. 312 U.S. 579 (1941).

by the religious members should be ones to which the religious order is also entitled. The religious member is least likely to be taxed if the services he performs are of a type related to the tax exempt purpose of the order.[128]

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128. Rev. Rul. 71, C.B. 1953-1, 18. A religious order might reasonably argue for a more liberal interpretation of its exempt purpose. Many religious orders have the purpose to minister to the spiritual needs of people and to help them live better lives. Consequently temporary employment in other professions and occupations like plumbing and carpentry may better aid members of those orders in understanding the problems of those whom it is the order's office to help.

Editor's Note: Since this comment went to the printer, a new Revenue Ruling, 79-132, 1979-16 I.R.B. 5, *amplifying* Rev. Rul. 77-290, 1977-2 C.B. 26, has been issued which continues the Internal Revenue Service's restrictive reading of duties required by a religious order. This Ruling concerns a member of a religious order who was directed by his order to become a military chaplain. The Ruling concludes that

> although the chaplain was required by the order to enter the Armed Forces . . . and to turn over to the order the wages earned, the direct relationship between the Armed Forces and the individual chaplain establishes an employer-employee and an agency relationship between them so that the service performed by the member as a chaplain is not considered the exercise of duties required by such order.

Consequently, the chaplain was required to include the entire amount of earnings in his gross income, and the earnings are subject both to income tax withholding and to Social Security contribution.