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Constitutional Law--Freedom of Religion--Tax Exempt Status of Church Property

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The Supreme Court decision in *Nash* hopefully resolves the controversy over disposition of a bad debt reserve upon the transfer of assets in a section 351 exchange. However, the opinion does not go so far as to say that a bad debt reserve may never be restored to income in a section 351 transfer. The decision was based on an exchange of assets for stock equal to the *net value* of accounts receivable. Therefore, where it can be determined that the value of stock issued to the transferor represents the face value of accounts receivable and disregards the bad debt reserve, there would be a "recovery" within the meaning of the tax benefit rule, and the recovery would be considered a taxable event. Whether or not the *Nash* decision will be applied to a section 337[26] liquidation with a similar factual situation is left unanswered; however, in light of the economic realities test applied in *Schmidt* and the apparent adoption of that principle by the Supreme Court in *Nash,* it seems likely that a section 337 liquidation would not be considered a taxable event.

Dennis C. Sauter

Constitutional Law—Freedom of Religion—
Tax Exempt Status of Church Property

The plaintiff, an owner of real property, brought suit in the New York courts seeking to enjoin the New York City Tax Commission from granting property tax exemptions to religious organizations on properties used solely for religious purposes. These exemptions were authorized by state constitutional[1] and statutory

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[26] INT. REV. CODE OF 1954, § 337 (a) General Rule.— If—

(1) a corporation adopts a plan of complete liquidation on or after June 22, 1954, and (2) within the 12-month period beginning on the date of the adoption of such plan, all of the assets of the corporation are distributed in complete liquidation, less assets retained to meet claims, then no gain or loss shall be recognized to such corporation from the sale or exchange by it of property within such 12-month period.

[1] N. Y. CONST. art. XVI, § 1:

Exemptions from taxation may be granted only by general laws. Exemptions may be altered or repealed except those exempting real or personal property used exclusively for religious, educational or charitable purposes as defined by law and owned by any corporation or association organized or conducted exclusively for one or more of such purposes and not operating for profit.

provisions,[2] but the plaintiff contended the exemptions indirectly required him to make a contribution to religious organizations in violation of his first amendment rights.[3] The court granted defendant's motion for summary judgment, dismissed the complaint, and this was affirmed by the Appellate Division of the Supreme Court[4] and the New York Court of Appeals.[5]

The United States Supreme Court noted probable jurisdiction.[6] *Held*: the exemptions were not unconstitutional. Even though interactions between church and state are proscribed by the first amendment, the proscription cannot be absolute. Establishment of a religion by the state connotes a greater involvement than the mere exemption of property from taxation. *Walz v. Tax Commission of the City of New York,* 397 U.S. 664 (1970).[7]

Chief Justice Burger, writing for the Court, did not deal with the primary argument of plaintiff in *Walz, i.e.,* whether a tax exemption is a subsidy. Instead the Court was satisfied with looking at the historical aspect of tax exemptions, saying:

> It is obviously correct that no one acquires a vested or protected right in violation of the Constitution by long use, even when that span of time covers our entire national existence and indeed predates it. Yet an unbroken practice of according the exemption to churches, openly and by affirmative state action, not covertly or by state inaction, is not something to be lightly cast aside. . . .[8]

The Court, putting great emphasis on historical precedent, was aided by past decisions which drew the line between church and

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[2] New York Real Property Tax Law § 420 (McKinney 1958):

> Real property owned by a corporation or association organized exclusively for the moral or mental improvement of men and women, or for religious, bible, tract, charitable, benevolent, missionary, hospital, infirmary, educational, public playground, scientific, literary, bar association, medical society, library, patriotic, historical or cemetery purposes . . . and used exclusively for carrying out thereupon one or more of such purposes . . . shall be exempt from taxation as provided in this section.

[3] U.S. CONST. amend. I, provides in part that "Congress shall make no law respecting an establishment of religion, or prohibiting the free exercise thereof. . . ."

[4] 30 App. Div. 2d 778, 292 N.Y.S.2d 353 (1968).

[5] 24 N.Y.2d 30, 298 N.Y.S.2d 711, 246 N.E.2d 517 (1969).

[6] 395 U.S. 957 (1969).

[7] 397 U.S. 664 (1970), *aff'g* 24 N.Y.2d 30, 298 N.Y.S.2d 711, 246 N.E.2d 517 (1969), *aff'g* 30 App. Div. 2d 778, 292 N.Y.S.2d 353 (1968).

[8] 397 U.S. 664, 678 (1970).

state. The holding in *Walz* is easier to understand after one examines those cases which influenced the *Walz* decision.

Past cases have upheld as constitutional a New Jersey statute providing bus service to all children attending public and parochial schools;[9] a New York law lending textbooks free to all students, public and parochial;[10] a Maryland statute designating Sunday a day of rest;[11] and a New York program excusing pupils from public instruction to take religious training outside the school.[12] However, in close decisions requiring minute examination of cases involving the Religion Clauses, the Court has held unconstitutional: a Maryland program allowing religious teaching on school property during school hours;[13] a Pennsylvania statute requiring daily Bible readings;[14] and a school district's order requiring daily recitation of a New York Regents' prayer.[15]

The decisions interpreting the religion clauses fall into three general categories—active cooperation,[16] absolute separation,[17] and co-operative separation.[18] The third doctrine presently used by the

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[9] Everson v. Board of Educ., 330 U.S. 1 (1947). Writing for the majority, Mr. Justice Black reasoned that, because of the legitimate secular interest in education, the state could not deny the benefits of busing to children because of their faith. In a West Virginia case, *State ex rel. Hughes v. Board of Educ.*, 174 S.E.2d 711 (W. Va. 1970), the court held that a law giving county boards of education the authority to provide at public expense adequate means of transportation for all school-age children living more than two miles from school required the county boards to provide transportation for parochial school children when such boards provided bus transportation at public expense for public school children.

[10] Board of Educ., v. Allen, 392 U.S. 236 (1968). Lending textbooks free to public and parochial students was upheld as a benefit to children, not schools.

[11] McGowan v. Maryland, 366 U.S. 420 (1961). The Court decided the state had a legitimate interest in providing a day of rest, and the fact that the day was Sunday did not bar the state from achieving its secular interest.

[12] Zorach v. Clauson, 343 U.S. 306 (1952).

[13] McCollum v. Board of Educ., 333 U.S. 203 (1948). The Court said that releasing pupils for religious training was "beyond all question" the use of the tax supported public school system "to aid religious groups to spread their faith." *Id.* at 210.

[14] Engel v. Vitale, 370 U.S. 421 (1962). The Court held that requiring prayers in school was not advancing secular interests and was in violation of the first amendment.

[15] Abingdon School Dist., v. Schempp, 374 U.S. 203 (1963). The statute required daily Bible readings and the recital of the Lord's Prayer in unison.

[16] 30 ALBANY L. REV. 58, 60, 61 (1966). Active cooperation has been rejected by the Court for the past two decades. It means only that the government cannot give one religion preferential treatment over others.

[17] *Id.* at 60, 61. Absolute separation prohibiting all intercourse between the spheres of governmental activity—direct or indirect—has also been rejected. *See e.g.*, Zorach v. Clauson, 343 U.S. 306 (1952).

[18] *Id.* 30 ALBANY L. REV. 58, 60, 61 (1966).

Court, recognizes separation of church and state but rejects the view that an application of the principle necessarily prohibits all intercourse between the two.[19] Combining the "cooperative separation" concept with the two-fold test set forth in *Schemmpp*[20] for judging the relationship of legislative enactments to religion—the purpose and the effect of the enactment—[21] the Court seemed to have a safe foundation for the *Walz* decision. True to precedent, the Court was consistent in maintaining the wall separating church and state while at the same time advancing a legitimate secular interest.[22] However, the rule that a state may not pass laws to "aid one religion, all religions, or prefer one religion over another" still endures.[23]

After examining religion clause cases prior to *Walz* and upon consideration of tradition in this country, it would have been virtually impossible for the Court to have reached any decision other than to uphold the tax exemptions. However, Chief Justice Burger, writing for the majority, may have sidestepped the real issue: Is the tax exemption a subsidy and thus a violation of the establishment clause? Instead, he warned against too much rigidity,[24] and further explained that in today's complex society some contact between church and state is inevitable.[25]

The Court noted that the exempt property is within a broad class of property owned by non-profit, quasi-public corporations, and believed taxation of such property would be against the public interest.[26] The Court lightly passed over the subsidy issue, admitting that churches are indirectly benefited,[27] but applying the strictest definition to subsidy[28] and denying that exemptions are subsidies,

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[19] *Id.*

[20] Abington School Dist. v. Schempp, 374 U.S. 203 (1960); *see* note 15 *supra.*

[21] If the purpose or primary effect of the enactment is "the advancement or inhibition of religion then the enactment exceeds the scope of legislative power as circumscribed by the Constitution. That is to say that to withstand the strictures of the establishment clause there must be a secular legislative purpose and a primary effect that neither advances nor inhibits religion." Abington School Dist. v. Schempp, 374 U.S. 203, 222 (1960).

[22] Everson v. Board of Educ., 330 U.S. 1 (1947).

[23] *Id.* at 15.

[24] 397 U.S. 664, 669 (1970).

[25] *Id.* at 676.

[26] *Id.* at 673.

[27] *Id.* at 674.

[28] One such definition was set forth in *Kennecott Copper Corp. v. State Tax Comm'n.*, 60 F. Supp. 181, 182 (D.C. Utah 1944). The court held, "[S]ubsidy . . . is . . . usually money, donated or given or appropriated by the Government through its proper agencies . . . ."

since the government does not grant part of its funds directly to churches. It is difficult to deny that, in a broader sense, tax exemptions are "aid," *né* subsidy. The Court ignored that part of *Everson* v. *Board of Education*[29] which said that government cannot pass laws which "aid any religion."

In his concurring opinion, Mr. Justice Brennan also relied on tradition, citing Mr. Justice Holmes' "a page of history is worth a volume of logic."[30] Although not denying that exemptions are aid, he nevertheless decided that an exemption is not a subsidy. Justice Brennan felt the involvement in *Walz* was only "passive",[31] and that exemptions were not among the evils feared when the establishment clause was put into the Constitution.[32]

Mr. Justice Brennan, expounding on the benefits society reaps as a result of the exemptions, pointed out the amount of involvement that would occur if churches were taxed, and in doing so may have indicated his position on a question that could possibly be the next step in the interpretation of the religion clauses: Whether or not taxation of churches is constitutional. He seemed to suggest that such a tax would interfere with the free exercise of religion.[33]

In another concurring opinion, Mr. Justice Harlan said that the tax exemption legislation does not affect religious participation nor favor benefits to religious over non-religious organizations.[34] He relied heavily on the fact that the exemptions were included within a general exemption for non-profit organizations.

Mr. Justice Douglas, in a vigorous dissent, focused squarely on the question and unequivocally declared, "A tax exemption is a subsidy."[35] He urged the Court to adhere to the *Torcaso v. Watkins*[36] decision which prohibited enactment of laws which aid "believers as against non-believers."

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[29] 330 U.S. 1, 15 (1947).
[30] New York Trust Co. v. Eisner, 256 U.S. 345, 349 (1921).
[31] 397 U.S. 666, 691 (1970).
[32] *Id.* at 682.
[33] *Id.* at 691. Mr. Justice Brennan stated that termination of tax exemptions would necessitate "tax valuation of church property, tax liens, tax foreclosures and the direct confrontations and conflicts which follow in the train of those legal processes." In footnote 12 of his concurring opinion in *Walz,* he said a tax might conflict with the demands of the free exercise clause.
[34] *Id.* at 696.
[35] *Id.* at 704.
[36] 367 U.S. 488 (1961). A Maryland test requiring declaration of belief in God as a prerequisite to holding office was declared invalid.

The majority opinion and the concurring opinions in *Walz* probably reached the only practical result, since the administrative aspects of a contrary decision might prove insurmountable, and the political repercussions substantial. In the majority opinion, the Chief Justice barely mentioned what could have been the Court's strongest argument for continuing exemption — "Granting tax exemptions . . . [is] a lesser involvement than taxing them [churches]."[37] For example, how would a tax on churches be computed? Would churches be classified as trusts, natural persons, or corporations?

A tax on churches would necessitate a certain amount of regulation which could be an interference with the free exercise of worship. And taxation of churches would mean that a certain amount of church money would have to set aside, thus reducing the amount to be spent on the activities which fall into the realm of secular interest, *i.e.,* supporting hospitals, schools and social welfare programs. The services churches provide might be curtailed because of fund shortages. Sick people would converge on other hospitals in the absence of church supported hospitals. Parochial students would spill into the already crowded public system. Hard-pressed state welfare programs would suffer with the greater demands. Naturally the public would bear the ultimate loss; state and federal budgets would have to allocate funds to provide some of the same services.

The churches, tax exempt, are a service to communities, as are other non-profit organizations, which as the Court pointed out,[38] also benefit from the same statutory and constitutional provisions. Therefore, a tax on religious organizations instituted by legislatures may be a greater state interference with religion than tax exemption. However, it appears inevitable that eventually some governing body will attempt such a tax, and, no doubt, the Supreme Court will have to decide its legality. As has been hinted, the Court might well find such an enactment unconstitutional.

After examining the emphasis the Court placed on the "hands-off" attitude this country has exhibited toward the matter of church taxation, and the stress it has placed on the fact that "free money"

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[37] 397 U.S. 664, 674-75 (1970).
[38] *Id.* at 688.

finds its way into the public sector for its best interests, it may be reasonably presumed the Court would examine closely any statute taxing the churches.

Charlotte Rolston

Due Process of Law—
Welfare Recipient's Right to Pre-termination Hearing

A New York City Department of Social Services procedure allowed welfare officials to discontinue assistance to welfare recipients without a hearing prior to the termination of benefits.[1] If a caseworker questioned a recipient's continued eligibility, he discussed the matter with the recipient. The caseworker could then recommend termination to a unit supervisor, who, if he concurred, forwarded a letter to the recipient stating the justification for the proposed termination. The recipient was then permitted to request review by a higher official and to support this request with a written statement. If the reviewing official affirmed the action assistance stopped immediately, and the recipient was informed by letter of the reasons for the action. Twenty New York City welfare recipients challenged the constitutionality of these procedures on the grounds they violated due process in that the procedures lacked any provision for personal appearance or oral presentation of evidence before the reviewing official and denied the recipient the right to confront and cross-examine adverse witnesses. A three-judge federal district court held that only a pre-termination evidentiary hearing would satisfy the requirements of due process.[2]

On appeal,[3] the United States Supreme Court in *Goldberg v. Kelly*[4] and its companion case *Wheeler v. Montgomery*[5] *held,* in a 5-3 decision,[6] that due process of law requires an adequate hearing

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[1] New York City Department of Social Services Procedure No. 68-18, implementing N. Y. Social Welfare Law § 351.26(b) (McKinney 1966).

[2] Kelly v. Wyman, 294 F. Supp. 893 (S.D.N.Y. 1968).

[3] *Prob. juris. noted sub nom.* Goldberg v. Kelly, 394 U.S. 971 (1969).

[4] 397 U.S. 254 (1970), *aff'g* 294 F. Supp. 893 (S.D.N.Y. 1968).

[5] 397 U.S. 280 (1970). In *Wheeler* a three-judge federal district court in California held that the opportunity for an informal conference with a caseworker before termination of benefits, coupled with a trial-type hearing subsequent to termination, satisfied due process.

[6] Majority opinion by Justice Brennan in which Douglas, J., Harlan, J., White, J., and Marshall, J., concurred. Justice Black dissented in a separate