

# IMPROPER TAXATION OF THE VOWED RELIGIOUS: HOW *GLENSHAW GLASS* PRINCIPLES CAN REESTABLISH HORIZONTAL EQUITY

**Abstract:** The 1955 U.S. Supreme Court decision in *Commissioner v. Glenshaw Glass Co.* defined income as all “undeniable accessions to wealth, clearly realized, and over which the taxpayers have complete dominion.” In cases where members of religious orders assign all earnings to their orders pursuant to the vow of poverty, this definition has not played a role in the courts’ evaluation of proper tax treatment. Consequently, tax treatment of the members of these orders has violated the fundamental principle of horizontal equity, which states that similarly situated taxpayers should receive similar tax treatment. Instead, the Internal Revenue Service and three federal appellate courts have applied a formulistic agency theory that makes it virtually impossible for the vowed religious who work outside their orders to exclude the assigned earnings from income. In doing so, the IRS and the courts have misapplied the U.S. Supreme Court’s assignment of income doctrine. Nonetheless, the agency theory has been applied in comparable non-religious contexts with favorable outcomes for the taxpayers. The inconsistent results demonstrate that the agency theory is flawed when it is applied to assignments made pursuant to the vow of poverty. This Note argues that courts should evaluate assignments of personal service income under the *Glenshaw Glass* “dominion and control” standard to reestablish horizontal equity and end the improper taxation of the vowed religious.

## INTRODUCTION

One might ask what do a Jesuit priest, an undercover cop, and a legal services attorney all have in common; the answer would not be equal tax treatment.<sup>1</sup> When a priest works outside his religious order with the order’s permission and remits his earnings directly to the order pursuant to his vow of poverty, three U.S. courts of appeals have held that he must include the earnings in his gross income and pay taxes on

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<sup>1</sup> See, e.g., *Fogarty v. United States*, 780 F.2d 1005, 1013 (Fed. Cir. 1986); Rev. Rul. 65-282, 1965-2 C.B. 21; Rev. Rul. 58-515, 1958-2 C.B. 28.

it.<sup>2</sup> When, however, an undercover police officer who receives income from a private employer during a covert operation remits it to the police department, the assigned income is excluded from his gross income.<sup>3</sup> A legal services attorney who turns over court fees paid to him directly to his employer receives similarly favorable tax treatment.<sup>4</sup> Yet each of these taxpayers transfers his or her earnings pursuant to either an employment agreement, general practice of the trade, or similar arrangement that renders ownership of the assigned income to another party.<sup>5</sup> As a result, none actually have a choice in assigning their earnings to third parties.<sup>6</sup> The inconsistency between vow-of-poverty cases and similar non-religious contexts suggests that the courts are either applying a flawed doctrine or misapplying a correct doctrine to decide these cases.<sup>7</sup>

When applied to transfers of earned income,<sup>8</sup> the assignment of income doctrine states that when a wage earner assigns any earnings to another party, he or she retains tax liability for the assigned income.<sup>9</sup> The agency theory creates an exception to the assignment of income doctrine by allowing a taxpayer to exclude the assigned income from

<sup>2</sup> See *Kircher v. United States*, 872 F.2d 1014, 1019 (Fed. Cir. 1989); *Schuster v. Comm'r*, 800 F.2d 672, 678 (7th Cir. 1986); *Fogarty*, 780 F.2d at 1006–07. Both *Fogarty* and *Kircher* were initially brought in the U.S. Claims Court as suits for refund of money wrongfully collected by the Internal Revenue Service (the “IRS”). See *Kircher*, 872 F.2d at 1014; *Fogarty*, 780 F.2d at 1007. The Claims Court, which is now the U.S. Court of Federal Claims, and the federal district courts have concurrent jurisdiction over refund claims against the IRS. See BORIS I. BITTKER ET AL., FEDERAL INCOME TAXATION OF INDIVIDUALS ¶ 51.08 (3d ed. 2002). Appeals from the Court of Federal Claims are brought before the U.S. Court of Appeals for the Federal Circuit. *Id.* *Schuster*, however, was initially litigated in the U.S. Tax Court. See 800 F.2d at 675–76. The Tax Court is the only venue available to taxpayers who wish to challenge the IRS tax assessments without first paying the tax deficiency. See BITTKER ET AL., *supra*, ¶ 51.03. Appeals from the Tax Court are brought before the U.S. court of appeals that has jurisdiction over the taxpayer’s place of residence. See *id.* ¶ 51.07.

<sup>3</sup> Rev. Rul. 58-515, 1958-2 C.B. 28.

<sup>4</sup> Rev. Rul. 65-282, 1965-2 C.B. 21.

<sup>5</sup> See *Fogarty*, 780 F.2d at 1009; Rev. Rul. 65-282, 1965-2 C.B. 21; Rev. Rul. 58-515, 1958-2 C.B. 28.

<sup>6</sup> See *Fogarty*, 780 F.2d at 1007; Rev. Rul. 65-282, 1965-2 C.B. 21; Rev. Rul. 58-515, 1958-2 C.B. 28.

<sup>7</sup> See *Fogarty*, 780 F.2d at 1013; Rev. Rul. 65-282, 1965-2 C.B. 21; Rev. Rul. 58-515, 1958-2 C.B. 28.

<sup>8</sup> Earned income is defined in the Internal Revenue Code as wages, salaries, tips, other employee compensation, and net earnings from self-employment. See I.R.C. § 32(c)(2) (2006). Income that is not considered earned includes interest and dividend income, pensions, social security and unemployment benefits, alimony, and child support. *What Is Earned Income?*, IRS, <http://www.irs.gov/individuals/article/0,,id=176508,00.html> (last visited Sept. 16, 2010).

<sup>9</sup> See *Lucas v. Earl*, 281 U.S. 111, 114–15 (1930). For a detailed overview of assignment of income doctrine, see generally Charles S. Lyon & James S. Eustice, *Assignment of Income: Fruit and Tree as Irrigated by the P.G. Lake Case*, 17 TAX L. REV. 293 (1962).

gross income when he or she received the assigned income as an agent for the assignee and under an obligation to forward the income to the assignee.<sup>10</sup> Although courts apply the agency theory to decide cases involving assignment of personal service income, the inconsistent results demonstrate that, when applied to assignments pursuant to vows of poverty, the agency theory is flawed.<sup>11</sup>

The difference in tax treatment of vow-of-poverty assignments and comparable non-religious assignments of income appears irreconcilable with horizontal equity, a core principle used to judge the fairness of a tax system.<sup>12</sup> Horizontal equity stands for the idea that taxpayers whose income and circumstances are substantially similar should bear similar tax burdens.<sup>13</sup> It guards against unfounded discrimination and ensures distributive justice<sup>14</sup> in spreading tax burdens on the population.<sup>15</sup>

Considerations of horizontal equity featured prominently in the 1955 case *Commissioner v. Glenshaw Glass Co.*, where the U.S. Supreme Court included in income all instances of “undeniable accessions to wealth, clearly realized, and over which the taxpayers have complete

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<sup>10</sup> Rev. Rul. 76-479, 1976-2 C.B. 20 (“[A]mounts received by an agent on behalf of a principal, and turned over to the principal, are not taxable to the agent under section 61(a) of the Code.”); see also Rev. Rul. 65-282, 1965-2 C.B. 21; Rev. Rul. 58-515, 1958-2 C.B. 28.

<sup>11</sup> See *Kircher*, 872 F.2d at 1019; *Schuster*, 800 F.2d at 678; *Fogarty*, 780 F.2d at 1013.

<sup>12</sup> See Joseph J. Cordes, *Horizontal Equity*, in THE ENCYCLOPEDIA OF TAXATION AND TAX POLICY 164 (Joseph J. Cordes et al. eds., 1999).

<sup>13</sup> See *id.*

<sup>14</sup> The concept of distributive justice is a normative foundation of tax policy. See Kevin A. Kordana & David H. Tabachnick, *Taxation, the Private Law, and Distributive Justice*, 23 SOC. PHIL. & POL’Y 142, 142–43 (2006). It concerns the fairness of allocation of benefits and burdens among individuals. See Thomas M. Porcano, *Distributive Justice and Tax Policy*, 59 ACCT. REV. 619, 620 (1984). Distributive justice can be used to evaluate how equitable a tax system is by comparing taxpayers’ benefits and burdens in terms of what they are entitled to and what they are actually apportioned. See *id.* Various distributive justice rules can be used to determine taxpayers’ deserved outcomes, including the contributions rule, needs rule, and equality rule. See *id.* at 620–22 (expressing the relationship of the rules mathematically and conducting a study to measure distributive justice of a tax policy). Discussion of distributive justice is part and parcel of tax policy debate, especially for those who view taxation as a way to address the widening income gap between the rich and poor. See Linda Sugin, *Theories of Distributive Justice and Limitations on Taxation: What Rawls Demands from Tax Systems*, 72 FORDHAM L. REV. 1991, 2013–14 (“[A]nyone who cares about distributive justice in the real world needs to pay close attention to taxation. It remains the most likely mechanism to address rising income inequality, wealth concentration, and the dangers to basic liberties that those economic patterns present.”).

<sup>15</sup> See Sugin, *supra* note 14, at 2013–14.

dominion” and control.<sup>16</sup> Yet, in assignment of income cases, courts do not frame the pertinent inquiry as whether the taxpayer had dominion over the income or control over its assignment.<sup>17</sup> The resulting inconsistency in treatment of members of religious orders who assign their earnings to their orders and other similarly situated taxpayers attests to a need to reanalyze judicial treatment of the doctrine as applied to vow-of-poverty cases.<sup>18</sup>

Despite the fact that the most recent federal case involving assignment of income pursuant to a vow of poverty was decided in 1989,<sup>19</sup> courts and scholars have yet to put forth a viable alternative to the agency theory that would address both fairness concerns and the inconsistency that has plagued the application of the agency theory. This Note argues that, instead of applying the agency theory, courts should address assignment of income from personal services under the *Glen-shaw Glass* standard by asking whether the assignment was within the dominion and control of the taxpayer.<sup>20</sup> Only then will similarly situated taxpayers receive equitable tax treatment.<sup>21</sup>

Part I provides a brief overview of two foundational principles of tax law relevant to this Note: gross income and horizontal equity.<sup>22</sup> Part I then examines the assignment of income doctrine as developed in three major U.S. Supreme Court cases.<sup>23</sup> Part II surveys the application of the agency theory in assignments of income in vow-of-poverty cases and several non-religious contexts.<sup>24</sup> Specifically, Part II explains the framework under which three federal circuit courts of appeals have analyzed assignment of income to religious orders.<sup>25</sup> Part III analyzes how core U.S. Supreme Court precedents on the assignment of income doctrine were misapplied in vow-of-poverty cases and illustrates the inconsistency of the agency theory by comparing its application in vow-of-poverty cases to similar assignments of income in non-religious con-

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<sup>16</sup> See 348 U.S. 426, 431 (1955). Although the Court only used the term “dominion,” subsequent cases have interpreted the language of the case to include the word “control.” See, e.g., *Erickson v. United States (In re Bentley)*, 916 F.2d 431, 432 (8th Cir. 1990).

<sup>17</sup> See *Kircher*, 872 F.2d at 1019; *Schuster*, 800 F.2d at 678; *Fogarty*, 780 F.2d at 1012.

<sup>18</sup> See, e.g., *Fogarty*, 780 F.2d at 1013; Rev. Rul. 65-282, 1965-2 C.B. 21; Rev. Rul. 58-515, 1958-2 C.B. 28.

<sup>19</sup> See *Kircher*, 872 F.2d at 1014.

<sup>20</sup> See 348 U.S. at 431.

<sup>21</sup> See *id.*

<sup>22</sup> See *infra* notes 28–42 and accompanying text.

<sup>23</sup> See *infra* notes 43–72 and accompanying text.

<sup>24</sup> See *infra* notes 73–182 and accompanying text.

<sup>25</sup> See *infra* notes 83–171 and accompanying text.

texts.<sup>26</sup> Finally, Part IV argues that cases involving assignment of personal service income should be evaluated under the dominion and control standard of *Glenshaw Glass* to resolve the inconsistency of the agency theory and ensure horizontal equity.<sup>27</sup>

## I. TAX PRINCIPLES AND THE ASSIGNMENT OF INCOME DOCTRINE

### A. Foundational Principles of Tax Law

Section 61(a)(1) of the Internal Revenue Code (the “Code”) defines gross income as “all income from whatever source derived.”<sup>28</sup> The Code thus evidences congressional intent to cast a wide net over sources of taxable receipt.<sup>29</sup> Although section 61 lists compensation for services as gross income, a question remains as to the effect of assignment of that income to a third party.<sup>30</sup> In essence, the Code answers the question of what must be taxed, but not who is liable to pay the tax.<sup>31</sup>

In 1955, the U.S. Supreme Court defined gross income in *Commissioner v. Glenshaw Glass Co.* as any “accessions to wealth, clearly realized, and over which the taxpayers have complete dominion” and control.<sup>32</sup> The plaintiffs argued that the punitive damages they had recovered in a prior commercial litigation suit did not constitute gross income within the meaning of the Code because the money was awarded as punishment to the defendants.<sup>33</sup> The Court, however, refused to give any significance to the source of income in deciding whether it was taxable gross income.<sup>34</sup> Instead, it crafted a definition that placed a premium on substance over form when determining whether a taxpayer actually receives an economic benefit that is within the taxpayer’s power to manage and direct.<sup>35</sup> Applying the definition to the facts of the case, the

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<sup>26</sup> See *infra* notes 183–271 and accompanying text.

<sup>27</sup> See *infra* notes 272–289 and accompanying text.

<sup>28</sup> I.R.C. § 61(a)(1) (2006).

<sup>29</sup> See *id.*

<sup>30</sup> See *id.*

<sup>31</sup> See *id.*

<sup>32</sup> 348 U.S. 426, 431 (1955).

<sup>33</sup> *Id.* at 427.

<sup>34</sup> See *id.* at 431.

<sup>35</sup> See *id.* For an analysis of the *Glenshaw Glass* definition of gross income in the context of windfall found objects such as home run baseballs that fans catch during games, see Joseph M. Dodge, *Accession to Wealth, Realization of Gross Income, and Dominion and Control: Applying the “Claim of Right Doctrine” to Found Objects, Including Record-Setting Baseballs*, 4 FLA. TAX REV. 685, 688 (2002).

Court held that punitive damages are gross income.<sup>36</sup> If the economic benefit is money, like employee wages, the requirement of dominion and control implies that the taxpayer must retain the ultimate decision-making capacity with respect to how the money is managed and spent.<sup>37</sup>

The substance-over-form nature of the gross income definition in *Glenshaw Glass* is consistent with a core principle of taxation that measures fairness of a tax system—horizontal equity.<sup>38</sup> Horizontal equity stands for the proposition that a tax system should allocate the burdens of tax equally among the taxpayers whose incomes and circumstances are substantially similar.<sup>39</sup> Its sister principle, vertical equity, requires that taxpayers with different incomes and circumstances shoulder different tax burdens.<sup>40</sup> If a tax policy violates horizontal equity, the policy is deeply flawed.<sup>41</sup> Several normative rationales for horizontal equity are prevalent, including vertical equity, economic efficiency, equal protection under the law, and morality of market distribution.<sup>42</sup>

### B. *Assignment of Income: The U.S. Supreme Court Precedents*

The U.S. Supreme Court developed and refined the assignment of income doctrine in three landmark cases decided between 1930 and 1944.<sup>43</sup> Each case involved a married couple that filed separate tax returns, with the wife claiming one half of her husband's earnings.<sup>44</sup>

<sup>36</sup> *Glenshaw Glass*, 348 U.S. at 432–33.

<sup>37</sup> *See id.* at 431.

<sup>38</sup> *See id.*; Cordes, *supra* note 12, at 164.

<sup>39</sup> Cordes, *supra* note 12, at 164. Although the generally accepted measure of income is annual income, lifetime income is an alternative measure embraced by many economists. *Id.* at 165. There is a more profound debate, however, as to whether similarities between taxpayers should be measured based on consumption instead of income. *Id.* Given that the U.S. tax system is income-based, the debate bears no practical consequences. *See id.*

<sup>40</sup> *Id.* For a discussion of a scholarly debate regarding whether horizontal equity is an independent principle or a subset of the principle of vertical equity, see generally Paul R. McDaniel & James R. Repetti, *Horizontal and Vertical Equity: The Musgrave/Kaplow Exchange*, 1 FLA. TAX. REV. 607 (1993).

<sup>41</sup> David Elkins, *Horizontal Equity as a Principle of Tax Theory*, 24 YALE L. & POL'Y REV. 43, 43–44 (2006); see also Adam M. Leamon, Note, *Section 108 of the I.R.C. and the Inclusion of Tufts Gain: A Proposal for Reform*, 50 B.C. L. REV. 1243, 1271 (2009) (“[H]orizontal equity is a fundamental criterion of a ‘good tax’ and its violation, while not fatal, indicates that tax burdens are not fairly distributed.”).

<sup>42</sup> See generally Elkins, *supra* note 41 (examining the different theoretical bases for horizontal equity and concluding that morality of market distribution is the only plausible justification).

<sup>43</sup> *See Comm’r v. Harmon*, 323 U.S. 44, 44–45 (1944); *Poe v. Seaborn*, 282 U.S. 101, 109 (1930); *Lucas v. Earl*, 281 U.S. 111, 113–14 (1930).

<sup>44</sup> *See Harmon*, 323 U.S. at 44–45; *Seaborn*, 282 U.S. at 109; *Earl*, 281 U.S. at 113–14.

The Court first addressed assignment of income in 1930 in the seminal case *Lucas v. Earl*, which held that income from personal services is taxed to the person who earns it.<sup>45</sup> Earl and his wife entered into a contract whereby each spouse was entitled to half of all future earnings of the other spouse.<sup>46</sup> The husband was the wage earner.<sup>47</sup> Instead of allowing each spouse to report half of the husband's income on separate tax returns, the Internal Revenue Service Commissioner (the "Commissioner") taxed Earl on his full salary.<sup>48</sup> The husband argued that because his agreement with his wife was an enforceable contract under state law, he should only be taxed on half of his salary.<sup>49</sup> Writing for a unanimous Court, Justice Holmes sided with the Commissioner, reasoning that taxpayers cannot avoid paying tax by using "anticipatory arrangements and contracts however skillfully devised to prevent the salary when paid from vesting even of a second in the man who earned it."<sup>50</sup> Viewed on its own, *Earl* prevents taxpayers who assign income from shifting tax liability to the assignee.<sup>51</sup> Commentators agree that this result was inevitable because a contrary ruling would have allowed taxpayers to avoid the progressive rate structure by assigning income to family members.<sup>52</sup>

*Earl*, however, was not the Court's final say on assignment of personal service income.<sup>53</sup> In fact, only a few weeks later in 1930, the Court decided *Poe v. Seaborn*, where a husband and wife also filed separate tax returns, each claiming half of the husband's earnings and investment

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<sup>45</sup> See 281 U.S. at 115.

<sup>46</sup> *Id.* at 113–14.

<sup>47</sup> *Id.* at 113.

<sup>48</sup> *Id.*

<sup>49</sup> *Id.* at 114.

<sup>50</sup> *Id.* at 115. The principle that a taxpayer cannot avoid tax liability by anticipatory arrangements has been followed in subsequent Supreme Court decisions. See, e.g., *United States v. Basye*, 410 U.S. 441, 449–50 (1973) (application of the principle to a partnership); *United States v. Joliet & Chi. R.R. Co.*, 315 U.S. 44, 48 (1942) (application of the principle to an arrangement involving a lessee of corporate property making payments to shareholders rather than the corporation).

<sup>51</sup> See *Earl*, 281 U.S. at 115.

<sup>52</sup> See MARVIN A. CHIRELSTEIN, *FEDERAL INCOME TAXATION* ¶ 8.01 (10th ed. 2005); Brant J. Hellwig, *The Supreme Court's Casual Use of the Assignment of Income Doctrine*, 2006 U. ILL. L. REV. 751, 774–75; Ronald H. Jensen, Schneer v. Commissioner: *Continuing Confusion over the Assignment of Income Doctrine and Personal Service Income*, 1 FLA. TAX REV. 623, 632 (1993). The concern about evading the progressive tax structure does not arise with non-gratuitous assignments of income because the assignor would need to include the consideration received for the assignment in his or her gross income. Jensen, *supra*, at 633.

<sup>53</sup> See *Seaborn*, 282 U.S. at 118.

income.<sup>54</sup> Despite the similarity of facts to *Earl*, the Court decided in *Seaborn* that the taxpayer was allowed to report only half of his earnings.<sup>55</sup> The Court distinguished *Earl* by noting that the taxpayer in *Seaborn* lived in Washington, a community property state where income of one spouse belongs equally to the other.<sup>56</sup> The earnings were “never the property of the husband, but that of the community,” making the assignment of income a result of the operation of state law.<sup>57</sup> The Court’s analytical distinction between *Earl* and *Seaborn*, however, may not be valid because the contract in *Earl* also had the effect of divesting the husband of ownership of half of his income, enforceable under state contract law.<sup>58</sup>

In *Commissioner v. Harmon*, decided in 1944, the Court added yet another wrinkle to the assignment of income doctrine.<sup>59</sup> Like in *Earl* and *Seaborn*, the taxpayer and his wife filed separate tax returns, each claiming one half of the husband’s income.<sup>60</sup> They did so after Oklahoma had adopted a community property law.<sup>61</sup> Unlike in *Seaborn*, however, where the community property law governed all married couples, Oklahoma had created an opt-in system whereby married individuals could choose whether to have the law apply to them.<sup>62</sup> The taxpayer and his wife had opted in, and so their current and future property belonged to a marital community rather than either spouse individually.<sup>63</sup> In accordance with what they argued was the holding in *Seaborn*, the couple chose to claim equal shares of the husband’s earnings, as well as certain investment income, in separate tax returns.<sup>64</sup>

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<sup>54</sup> *Id.* at 109.

<sup>55</sup> *Id.* at 118.

<sup>56</sup> *Id.* at 111, 117. A community property state refers to “[a] state in which spouses hold property that is acquired during their marriage (other than property acquired by inheritance or gift) as community property.” BLACK’S LAW DICTIONARY 318 (9th ed. 2009).

<sup>57</sup> *Seaborn*, 282 U.S. at 117. The Court’s reasoning and the decision’s effect on community property spouses even led to calls for Congress to override the decision. See Susan Kalinka, *Taxation of Community Income: It Is Time for Congress to Override Poe v. Seaborn*, 58 LA. L. REV. 73, 74 (1997). In 1971, however, the Supreme Court declined to overturn *Seaborn*, and it remains good law. See *United States v. Mitchell*, 403 U.S. 190, 194–95 (1971).

<sup>58</sup> Hellwig, *supra* note 52, at 768. Professor Hellwig has concluded that “[a]t the end of the day, the analyses in *Lucas v. Earl* and *Poe v. Seaborn* remain irreconcilable.” *Id.* at 769.

<sup>59</sup> See 323 U.S. at 48.

<sup>60</sup> *Id.* at 45.

<sup>61</sup> *Id.* at 44–45.

<sup>62</sup> *Id.*

<sup>63</sup> *Id.*

<sup>64</sup> See *id.* at 45.

The Commissioner assessed a tax deficiency, claiming that the husband was subject to tax on his entire earnings under *Earl*.<sup>65</sup>

The Supreme Court agreed with the Commissioner.<sup>66</sup> The Court reasoned that the opt-in, elective nature of the community property law rendered it more akin to the voluntary spousal contract in *Earl* than the “incident of marriage” imposed by the state in *Seaborn*.<sup>67</sup> The Court thereby distinguished between a “consensual community” that arises out of a contract and a “legal community” that arises out of the legal relationship of marriage itself.<sup>68</sup> In his dissent, Justice Douglas challenged the dichotomy as artificial because marriage itself can be seen as a voluntary, consensual contract.<sup>69</sup> Seen in this light, Justice Douglas argued, community property is also a result of contract.<sup>70</sup> Furthermore, scholars point out that, in practice, non-elective community property states are not so different from Oklahoma’s opt-in system, as spouses can choose by contract not to participate in the community property system.<sup>71</sup> Despite its flaws, *Harmon* does add to the assignment of personal service income doctrine by holding that for the assignment to shift the tax burden from assignor to assignee, it must be mandated as part and parcel of the underlying legal relationship between the two parties.<sup>72</sup>

## II. THE AGENCY THEORY APPLIED TO ASSIGNMENTS OF INCOME

The U.S. courts of appeals have decided three cases that challenged the Commissioner’s assessment of individual tax liability on members of religious orders who assigned income to their orders; in each case, the courts applied a demanding agency theory to determine whether the assignor or assignee should bear tax liability.<sup>73</sup> In each case, the courts found that members were not agents of their orders and were

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<sup>65</sup> See *Harmon*, 323 U.S. at 45–46.

<sup>66</sup> *Id.* at 46.

<sup>67</sup> See *id.*

<sup>68</sup> *Id.*

<sup>69</sup> *Id.* at 53 (Douglas, J., dissenting).

<sup>70</sup> See *id.*; see also Hellwig, *supra* note 52, at 769 (“If an affirmative election by spouses to opt in to a state law community property system was enough for the community to be viewed as a contractual arrangement, one could just as easily argue that the contract of marriage renders all community law regimes similarly consensual in nature.”).

<sup>71</sup> See JOSEPH WILLIAM SINGER, INTRODUCTION TO PROPERTY 411 (2d ed. 2005); Hellwig, *supra* note 52, at 768–69.

<sup>72</sup> See *Harmon*, 323 U.S. at 46–47.

<sup>73</sup> See *Kircher v. United States*, 872 F.2d 1014, 1018 (Fed. Cir. 1989); *Schuster v. Comm’r*, 800 F.2d 672, 678 (7th Cir. 1986); *Fogarty v. United States*, 780 F.2d 1005, 1012 (Fed. Cir. 1986).

individually liable to pay tax on the assigned income.<sup>74</sup> Meanwhile, in prior revenue rulings by the Internal Revenue Service (“IRS”) involving comparable non-religious assignments of income, a less demanding agency theory was applied, and the taxpayers were not liable to pay tax on the assigned income.<sup>75</sup>

Agency is a relationship that develops when one party, the agent, consents to act on behalf of and under the control of another party, the principal.<sup>76</sup> The relationship can result from express contract or implied agreement between the parties so long as it is apparent that there is mutual consent that the agent will function not as an individual but as representative of the principal.<sup>77</sup>

The application of the agency theory to assignment of personal service income cases stems from the U.S. Supreme Court’s 1920 decision in *Maryland Casualty Co. v. United States*.<sup>78</sup> The issue before the Court was whether, for excise tax purposes, an insurance company receives premium payments when its insurance agents receive them from the customers, or when the agents actually transmit them to the company’s treasurer.<sup>79</sup> Although *Maryland Casualty* did not consider whether the insurance company or its agent were subject to taxation on the premiums, it is nonetheless cited for the proposition that principals, not agents, are taxable on amounts that agents receive on behalf of the principals.<sup>80</sup> The rationale for not taxing the agent is that right of control over the funds belongs to the principal.<sup>81</sup>

As discussed in Sections A and B of this Part, when the agency theory was applied to assignments of income pursuant to vows of poverty and assignments in comparable non-religious contexts, it yielded inconsistent results.<sup>82</sup>

<sup>74</sup> See *Kircher*, 872 F.2d at 1018; *Schuster*, 800 F.2d at 678; *Fogarty*, 780 F.2d at 1012.

<sup>75</sup> See Rev. Rul. 65-282, 1965-2 C.B. 21; Rev. Rul. 58-515, 1958-2 C.B. 28.

<sup>76</sup> See RESTATEMENT (THIRD) OF AGENCY § 1.01 (2006).

<sup>77</sup> See *id.* § 1.01 cmt. d. Inherent in the definition of agency is the existence of a consensual relation. *Id.*

<sup>78</sup> 251 U.S. 342, 344 (1920).

<sup>79</sup> *Id.*

<sup>80</sup> See, e.g., *Fogarty*, 780 F.2d at 1008–09 (citing generally *Md. Casualty*, 251 U.S. 342).

<sup>81</sup> See *Md. Casualty*, 251 U.S. at 347.

<sup>82</sup> See *Kircher*, 872 F.2d at 1018; *Schuster*, 800 F.2d at 678; *Fogarty*, 780 F.2d at 1012; Rev. Rul. 65-282, 1965-2 C.B. 21; Rev. Rul. 58-515, 1958-2 C.B. 28. For a discussion of the principal-agent relationship between members and their religious orders in the context of tort liability, see generally David Frohlich, Note, *Will Courts Make Changes for a Large Denomination?: Problems of Interpretation in an Agency Analysis in Which a Religious Denomination is Involved in an Ascending Liability Tort Case*, 72 IOWA L. REV. 1377 (1987); *infra* notes 83–182.

### A. Members of Religious Orders as Agents of the Orders

Since the Supreme Court's decision in *Maryland Casualty Co.*, assignment of personal service income has arisen in varied contexts with inconsistent results, most notably in cases involving members of religious orders who, having taken perpetual vows of poverty, assigned their income to their orders.<sup>83</sup> Two U.S. courts of appeals, in three different vow-of-poverty cases, applied the agency theory through similar multifactorial analyses.<sup>84</sup> In all three cases members working outside their orders were found to be acting in their individual capacities, rather than as agents of their orders, and as a result bore the tax liability for their earned but assigned income.<sup>85</sup>

#### 1. Legal Enforceability of Vows of Poverty and the IRS Policy

To fully appreciate the circumstances surrounding vow-of-poverty cases, it is first necessary to understand the legal effects of a vow of poverty.<sup>86</sup> After the U.S. Supreme Court upheld the legal enforceability of vows of poverty,<sup>87</sup> the IRS treated all members who assigned income to their orders as agents of those orders until it changed course in the 1970s in response to a tax protest movement.<sup>88</sup>

In 1914, the U.S. Supreme Court held in *Order of St. Benedict of New Jersey v. Steinhauser* that vows of poverty are legally enforceable.<sup>89</sup> After a member of the Order of St. Benedict, Father Wirth, died, the order filed suit to establish legal ownership over the decedent's property.<sup>90</sup> The property included income from sale of the member's published books and copyrights in those books.<sup>91</sup> To become a member of the order, Wirth had taken vows of poverty and obedience, agreeing that any property he had or later obtained, including earnings, would become common property of the order.<sup>92</sup> The Court held that vows of poverty are enforceable and that the property legally belonged to the

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<sup>83</sup> See *Kircher*, 872 F.2d at 1019; *Schuster*, 800 F.2d at 678; *Fogarty*, 780 F.2d at 1007.

<sup>84</sup> See *Kircher*, 872 F.2d at 1018–19; *Schuster*, 800 F.2d at 678; *Fogarty*, 780 F.2d at 1012.

<sup>85</sup> See *Kircher*, 872 F.2d at 1019; *Schuster*, 800 F.2d at 679; *Fogarty*, 780 F.2d at 1013.

<sup>86</sup> See *Order of St. Benedict of N.J. v. Steinhauser*, 234 U.S. 640, 644–45 (1914). For a thorough discussion of the role of courts in interpreting ecclesiastical issues, see generally Marianne Perciaccante, Note, *The Courts and Canon Law*, 6 CORNELL J.L. & PUB. POL'Y 171 (1996).

<sup>87</sup> See *Steinhauser*, 234 U.S. at 644–45.

<sup>88</sup> See Rev. Rul. 68-123, 1968-1 C.B. 35; O.D. 119, 1 C.B. 82 (1919).

<sup>89</sup> See 234 U.S. at 644–45.

<sup>90</sup> *Id.* at 641.

<sup>91</sup> *Id.* at 644.

<sup>92</sup> *Id.* at 643.

order, even though Wirth in fact had retained ownership of the property until his death.<sup>93</sup> Wirth essentially had held the property as a trustee for the benefit of the order.<sup>94</sup> In its rationale, the Court emphasized that the validity of the vow of poverty was reinforced by the order's corporate charter, which established the vow of poverty as a condition of membership.<sup>95</sup>

After *Steinhauser*, the IRS created what became a long-standing policy of allowing members of religious orders who abide by their vows of poverty to exclude from gross income earnings turned over to their orders.<sup>96</sup> The IRS based its rationale on the agency theory, which was later redefined to disallow the exclusion.<sup>97</sup> Essentially, those members who receive income as agents of their orders were not subject to tax on the assigned income, while those who earned the assigned income in their individual capacities were taxable.<sup>98</sup> From 1919 until 1977, the IRS treated all assignments of income from members to their orders as occurring pursuant to valid agency relationships, so long as the members in fact adhered to their vows of poverty by giving all of their earnings to their respective orders.<sup>99</sup>

In 1977, however, the IRS changed its position in response to a tax protest movement that sought to take advantage of the favorable tax treatment of members of religious orders.<sup>100</sup> The schemes involved protesters becoming ordained as ministers of mail order churches, taking vows of poverty, assigning their income to the fictitious churches, and then receiving access to this income for living expenses.<sup>101</sup> The IRS responded in Revenue Ruling 77-290 and limited the scope of the cases where assignment of income to a religious order would free the member of tax obligations to two circumstances: (1) where a member per-

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<sup>93</sup> *Id.* at 644-45.

<sup>94</sup> *See id.* at 646.

<sup>95</sup> *Steinhauser*, 234 U.S. at 648.

<sup>96</sup> O.D. 119, 1 C.B. 82 (1919) ("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."); *see also* Rev. Rul. 68-123, 1968-1 C.B. 35.

<sup>97</sup> O.D. 119, 1 C.B. 82 (1919).

<sup>98</sup> *Id.*

<sup>99</sup> Bridget R. O'Neill, Note, *Schuster v. Commissioner: An Appropriate Agency Test for Members of Religious Orders Working Under Vows of Poverty?*, 1988 Wis. L. Rev. 111, 116 n.39.

<sup>100</sup> *See, e.g.*, Page v. Comm'r, 51 T.C.M. (CCH) 1351, 1356-57 (1986); Speakman v. Comm'r, 51 T.C.M. (CCH) 939, 941 (1986); Noberini v. Comm'r, 45 T.C.M. (CCH) 587, 588 (1983); McGahen v. Comm'r, 76 T.C. 468, 479-80 (1981).

<sup>101</sup> *See Page*, 51 T.C.M. (CCH) at 1353-55; *Speakman*, 51 T.C.M. (CCH) at 940; *Noberini*, 45 T.C.M. (CCH) at 587-88; *McGahen*, 76 T.C. at 470-75.

forms services for his or her church or an associated institution; or (2) where a member who works outside the order does not enter into a legal employer-employee relationship with the outside employer.<sup>102</sup>

The IRS applied its new, limited scope of the agency relationship to the facts of Revenue Ruling 77-290.<sup>103</sup> It ruled that a nun working as a secretary at her church's business office was acting as an agent of her order because she was working for an employer affiliated with her order.<sup>104</sup> As a result, she could exclude from gross income her earnings because she assigned them to her order.<sup>105</sup> In the same ruling, however, the IRS also decided that a member who worked as an attorney at a law firm per instructions of his order did not receive income as an agent of his order, because he was legally an employee and agent of the law firm.<sup>106</sup> Implicit in the ruling is the Commissioner's stance that a member who works for an outside employer with the order's permission—but without a contract between the order and the employer for the member's services—is not an agent of the order for tax purposes.<sup>107</sup>

The distinction between members who work inside their orders or for an affiliated organization and members who work for unrelated outside employers does not take into account important similarities between the two groups.<sup>108</sup> In three cases challenging the Commissioner's assessment that income assigned to religious orders is nonetheless taxable to members individually, three U.S. courts of appeals rejected the theoretical distinction drawn by the Commissioner.<sup>109</sup>

## 2. Demanding Agency Requirements in Vow-of-Poverty Cases: *Fogarty*, *Schuster*, and *Kircher*

Following the IRS policy change regarding the taxability of members who assign income to their religious orders pursuant to vows of poverty, two circuit courts heard appeals in three different cases from members against whom the Commissioner had assessed personal tax

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<sup>102</sup> Rev. Rul. 77-290, 1977-2 C.B. 26. At the end of the decision, the Commissioner specifically stated that "O.D. 119 is superseded since the conclusion set forth therein is restated under current law in this Revenue Ruling." *Id.*

<sup>103</sup> *See id.*

<sup>104</sup> *Id.*

<sup>105</sup> *Id.*

<sup>106</sup> *Id.*

<sup>107</sup> *See* Rev. Rul. 77-290, 1977-2 C.B. 26.

<sup>108</sup> *See id.*

<sup>109</sup> *See Kircher*, 872 F.2d at 1018; *Schuster*, 800 F.2d at 678; *Fogarty*, 780 F.2d at 1012.

liability.<sup>110</sup> The courts analyzed the cases under the agency theory and found in favor of the Commissioner.<sup>111</sup>

In 1986, the U.S. Court of Appeals for the Federal Circuit held in *Fogarty v. United States* that the agency theory applies in cases involving assignment of income pursuant to a vow of poverty.<sup>112</sup> Father Fogarty, a Roman Catholic priest and member of the Society of Jesus, sought and received permission from his order to teach in the Department of Religious Studies at the University of Virginia.<sup>113</sup> Although the University understood that Father Fogarty's teaching position was conditioned upon continued approval by the order to ensure conformity with the Jesuit teaching tradition, the university did not contract directly with the order for Fogarty's services.<sup>114</sup> Bound by his vow of poverty and obedience, Fogarty could not own any property.<sup>115</sup> As a result, he instructed the university to deposit his checks into a checking account jointly owned by him and the order.<sup>116</sup> This arrangement was necessary because the university issued checks in Fogarty's name.<sup>117</sup> Fogarty did not file tax returns because he believed the earnings he turned over to the order were not includable in his gross income.<sup>118</sup> After the Claims Court ruled that Fogarty was obligated to pay taxes on his earnings, Fogarty appealed to the Federal Circuit.<sup>119</sup>

The court framed the dispute as a debate over whether the U.S. Supreme Court's 1930 decision in *Lucas v. Earl*, or the Court's decision that same year in *Poe v. Seaborn*, was controlling.<sup>120</sup> The court distinguished Fogarty from *Seaborn* by reasoning that the assignment of half of the husband's salary to his wife in *Seaborn* allowed the husband to exclude it from income because of the legal operation of the state community property laws.<sup>121</sup> In *Fogarty*, on the other hand, the legal relationship between the order and Fogarty, although enforceable in

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<sup>110</sup> See *Kircher*, 872 F.2d at 1014–15; *Schuster*, 800 F.2d at 675–76; *Fogarty*, 780 F.2d at 1007.

<sup>111</sup> See *Kircher*, 872 F.2d at 1018; *Schuster*, 800 F.2d at 678; *Fogarty*, 780 F.2d at 1012–13.

<sup>112</sup> *Fogarty*, 780 F.2d at 1012.

<sup>113</sup> *Id.* at 1006–07.

<sup>114</sup> *Id.* at 1007.

<sup>115</sup> *Id.*

<sup>116</sup> *Id.*

<sup>117</sup> *Id.*

<sup>118</sup> *Fogarty*, 780 F.2d at 1007.

<sup>119</sup> *Id.*

<sup>120</sup> See *id.* at 1008–09 (citing generally *Lucas v. Earl*, 281 U.S. 111 (1930) and *Poe v. Seaborn*, 282 U.S. 101 (1930)).

<sup>121</sup> *Id.* at 1009.

civil courts, was established not by state but by canon law.<sup>122</sup> Absent the special circumstances in *Seaborn* that allowed the taxpayer to exclude the assigned earnings from income, the court in *Fogarty* decided that the Supreme Court's precedent in *Earl* applied to require Fogarty to pay taxes on the income he assigned to his order.<sup>123</sup>

The *Fogarty* court nonetheless rejected the Commissioner's stance in Revenue Ruling 77-290 that the basis for determining whether a member acts as an agent for his or her religious order is the existence of a contract between the employer and the order.<sup>124</sup> Instead, the court created a multifactorial test for determining agency.<sup>125</sup> Relevant factors include: (1) degree of control the order exercises over the member; (2) ownership rights between member and order; (3) relation between mission of the order and type of work the member performs; (4) interactions between the member and the employer; and (5) interactions between the employer and the order.<sup>126</sup> The Federal Circuit did not weigh the factors because it was convinced that the trial court had duly considered all the facts.<sup>127</sup> The trial court had reasoned that the university offered the teaching post to Fogarty, not to the order, and exercised supervisory control over his work as a professor.<sup>128</sup> There were no interactions between the university and the order, except for the university officials' knowledge that Fogarty was a Jesuit bound to obey the order's decisions.<sup>129</sup> As a result, the court concluded that there was no basis for overturning the Claims Court's finding that Fogarty earned income in his individual capacity, rather than as an agent of the order.<sup>130</sup>

The U.S. Court of Appeals for the Seventh Circuit applied the *Fogarty* test in *Schuster v. Commissioner*, another case decided in 1986 that challenged taxation of members of religious orders.<sup>131</sup> A Roman Catholic nun, after receiving her order's approval, accepted a nurse midwife position in a clinic serving low-income residents.<sup>132</sup> The position accorded with the order's mission of promoting education and providing

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<sup>122</sup> *Id.*

<sup>123</sup> *See id.* at 1009–10.

<sup>124</sup> *See Fogarty*, 780 F.2d at 1012.

<sup>125</sup> *See id.*

<sup>126</sup> *Id.*

<sup>127</sup> *See id.* at 1012–13.

<sup>128</sup> *Id.* at 1008.

<sup>129</sup> *Id.* at 1007.

<sup>130</sup> *Fogarty*, 780 F.2d at 1013.

<sup>131</sup> *See Schuster*, 800 F.2d at 678; *see also* Francine M. Corcoran, *Seventh Circuit's Taxation of Members of Religious Orders: A Change of Habit*, 31 CATH. LAW. 62, 72–73 (1987).

<sup>132</sup> *Schuster*, 800 F.2d at 674.

health care.<sup>133</sup> Like Father Fogarty, Sister Schuster was required to take vows of poverty, chastity, and obedience.<sup>134</sup> Schuster specifically agreed “never [to] claim . . . any wages, compensation, remuneration, or reward” for services or work performed while she remained a member of the order.<sup>135</sup> Unlike in *Fogarty*, Schuster’s order sent a letter to her outside employer contracting for Schuster’s services and requesting that payment for her services be made directly to the order.<sup>136</sup> The director of the clinic responded with a letter formally accepting Schuster as a staff member.<sup>137</sup> The director informed the order that checks would be payable to Schuster, but that Schuster could endorse them and forward them to the order.<sup>138</sup> National Health Services Corps, a division of the United States Public Health Service that provided a grant for Schuster’s services, did not respond to a similar letter.<sup>139</sup> Schuster mailed all of her endorsed checks to the order.<sup>140</sup>

The Seventh Circuit adopted the Federal Circuit’s agency theory from *Fogarty* and similarly concluded that Schuster earned income in her individual capacity.<sup>141</sup> Although she was “obligated to subjugate her will to that of the Order,” the court noted that Schuster could withdraw from the order at any time.<sup>142</sup> The court purported to consider all of the *Fogarty* factors, but ultimately emphasized that, although the order had the authority to do so, it did not maintain day-to-day control over Schuster’s activity.<sup>143</sup> This control was instead exercised by her outside employer.<sup>144</sup> The court also highlighted that the payroll checks were issued to Schuster, and then went so far as to reason that her failure to insist that payments be issued to the order directly was “plainly inconsistent” with her earning income as an agent of the order.<sup>145</sup>

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<sup>133</sup> *Id.* at 678.

<sup>134</sup> *See id.* at 673.

<sup>135</sup> *Id.*

<sup>136</sup> *See id.* at 674–75.

<sup>137</sup> *Id.* at 675.

<sup>138</sup> *Schuster*, 800 F.2d at 675.

<sup>139</sup> *Id.*

<sup>140</sup> *Id.*

<sup>141</sup> *See id.* at 678. The Tax Court had reached the same conclusion by relying on a “triangle agency” theory. *See Schuster v. Comm’r*, 84 T.C. 764, 775–76 (1985). Under the triangle agency theory, the religious order would need to be contractually bound to provide the member’s services to the outside employer. *See id.* at 774; Jensen, *supra* note 52, at 648.

<sup>142</sup> *Schuster*, 800 F.2d at 678.

<sup>143</sup> *See id.*

<sup>144</sup> *Id.* at 679.

<sup>145</sup> *Id.*

Judge Richard D. Cudahy, dissenting in *Schuster*, argued that the majority misapplied the *Fogarty* test by requiring that the order exercise day-to-day control over Schuster's activities, and by largely ignoring the fact that the order had continued to supervise Schuster's work to ensure its compliance with the order's mission.<sup>146</sup> One specific instance of the order's meaningful control over Schuster's performance of her nurse midwife position involved its directive, which was accepted by the clinic, that Schuster not be required to supply contraceptives to the clinic's patients.<sup>147</sup> Judge Cudahy claimed that each of the *Fogarty* factors in fact pointed to a genuine agency relationship that should exempt Schuster from tax on income earned at the clinic.<sup>148</sup> Even so, Judge Cudahy suggested a three-factor test as an alternative to the formulaic *Fogarty* test.<sup>149</sup> First, the order's control over the member's activities must be meaningful.<sup>150</sup> According to Judge Cudahy, this factor was satisfied because Schuster needed to seek the order's consent to begin and terminate the work relationship, and the order could require her to abstain from work that "conflict[ed] with a moral precept observed by the Order," as had occurred with the distribution of contraceptives.<sup>151</sup> Second, the order must have the right of ownership over the member's income.<sup>152</sup> As the Supreme Court had held in *Steinhauser* that vows of poverty result in legal title to a member's property that is transferred to the member's order, Judge Cudahy suggested that ownership was satisfied in cases where, as here, the vow is actually respected, and all earnings are remitted to the order.<sup>153</sup> Third, there must be symmetry between the order's mission and the member's employment.<sup>154</sup> Judge Cudahy deemed this factor satisfied because the Schuster worked to help the poor per her order's authorization.<sup>155</sup>

In 1989, three years after deciding *Fogarty*,<sup>156</sup> the Federal Circuit decided *Kircher v. United States*, which is the third and, as of now, final circuit court case addressing assignment from members to their or-

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<sup>146</sup> *Id.* at 681 (Cudahy, J., dissenting).

<sup>147</sup> *Id.* at 682.

<sup>148</sup> *Schuster*, 800 F.2d at 680 (Cudahy, J., dissenting).

<sup>149</sup> *Id.* at 682. Bridget O'Neill, cited *supra* note 99, also favors Judge Cudahy's test. She argues that Judge Cudahy's test escapes the formalism embedded in the *Fogarty* test. See O'Neill, *supra* note 99, at 136–38.

<sup>150</sup> *Schuster*, 800 F.2d at 682 (Cudahy, J., dissenting).

<sup>151</sup> *Id.*

<sup>152</sup> *Id.*

<sup>153</sup> See *id.*; see also *Steinhauser*, 234 U.S. at 644–45.

<sup>154</sup> *Schuster*, 800 F.2d at 683 (Cudahy, J., dissenting).

<sup>155</sup> *Id.*

<sup>156</sup> See *Fogarty*, 780 F.2d at 1013.

ders.<sup>157</sup> The court followed its decision in *Fogarty* and disallowed the exclusion from gross income of assigned earnings.<sup>158</sup> In *Kircher*, two Roman Catholic priests were assigned to work as chaplains at public mental hospitals.<sup>159</sup> Although they went through the hospitals' hiring processes, the hospitals required that the order first appoint the chaplain candidates.<sup>160</sup> In both cases the ecclesiastical body appointed one candidate for the position and recommended this person to the hospital.<sup>161</sup> Only ordained priests were eligible for the chaplaincy.<sup>162</sup> As in *Fogarty* and *Schuster*, the members transmitted their checks to their order in accordance with their vows of poverty and obedience.<sup>163</sup> The checks were payable to the priests but endorsed to their order.<sup>164</sup> Although both chaplains were under the general supervision of the hospitals, neither hospital supervised the day-to-day religious duties of the chaplains.<sup>165</sup> Instead, the chaplains' religious superiors would visit to monitor the performance of their duties.<sup>166</sup>

In reaching its decision, the Federal Circuit first emphasized that whether assignment of income to the order would result in exclusion from gross income of the members depended on a totality-of-circumstances approach to agency principles.<sup>167</sup> Specifically, the court noted that the factors it had listed in *Fogarty* were intended as guideposts, rather than absolute requirements.<sup>168</sup> Even so, the court concluded that this case was not distinguishable from *Fogarty*, emphasizing the fact that the employment relationships between the chaplains and hospitals existed without any contractual understandings between the hospitals and religious order.<sup>169</sup> The court de-emphasized the crucial difference between *Fogarty* and this case, namely that here, the employers had in fact established a relationship with the order by looking to the order to appoint candidates and relying on the order's recommen-

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<sup>157</sup> See *Kircher*, 872 F.2d at 1014–15.

<sup>158</sup> See *id.* at 1019.

<sup>159</sup> *Id.* at 1015–16.

<sup>160</sup> *Id.* at 1016.

<sup>161</sup> *Id.* at 1016–17.

<sup>162</sup> *Id.* at 1016.

<sup>163</sup> See *Kircher*, 872 F.2d at 1016–17.

<sup>164</sup> *Id.*

<sup>165</sup> *Id.*

<sup>166</sup> *Id.*

<sup>167</sup> See *id.* at 1018.

<sup>168</sup> *Id.*

<sup>169</sup> *Kircher*, 872 F.2d at 1019.

dations when deciding whom to hire.<sup>170</sup> In holding that the two priests were not agents of their order for income tax purposes, the Federal Circuit in *Kircher* followed its precedent in *Fogarty* and the Seventh Circuit's decision in *Schuster* in imposing tax liability on the vowed religious who assign personal service income to their orders.<sup>171</sup>

### B. *Less Demanding Agency Theory in Non-Religious Assignments*

The agency theory as applied in cases involving members' assignment of income to religious orders is inconsistent with results in IRS revenue rulings involving comparable assignments of personal income.<sup>172</sup> One such case involved an undercover police officer who assigned earnings from a private employer to the police department.<sup>173</sup> Another case concerned a legal aid society's lawyers who assigned court fees to the society.<sup>174</sup> Results in these cases demonstrate that agency relationships were found despite the absence of agency factors that are required in vow-of-poverty cases.<sup>175</sup>

In Revenue Ruling 58-515, an undercover police officer received compensation from a private employer during a covert operation and remitted it to the Police Pension Fund in accordance with the police department's policy.<sup>176</sup> In deciding that the police officer was not required to include the compensation assigned to the Fund, the IRS reasoned that the officer earned the income as an agent of the police department.<sup>177</sup> The officer did not disclose his identity to the private employer, which meant that the outside employer was unaware of any relationship the officer had with the police department.<sup>178</sup> The finding of an agency relationship by the IRS, which enabled the taxpayer to exclude from gross income the earnings assigned to a third party, did not address any of the factors deemed necessary for determining agency in *Fogarty* and *Schuster*.<sup>179</sup>

Similarly, in Revenue Ruling 65-282, a legal aid society's lawyers were allowed to exclude from gross income money received for court-

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<sup>170</sup> See *id.* at 1019–20. In fact, at least one of the hospitals always hired the priest that the order had recommended. See *id.* at 1017.

<sup>171</sup> See *id.* at 1018; *Schuster*, 800 F.2d at 678; *Fogarty*, 780 F.2d at 1012–13.

<sup>172</sup> See Rev. Rul. 65-282, 1965-2 C.B. 21; Rev. Rul. 58-515, 1958-2 C.B. 28.

<sup>173</sup> See Rev. Rul. 58-515, 1958-2 C.B. 28.

<sup>174</sup> See Rev. Rul. 65-282, 1965-2 C.B. 21.

<sup>175</sup> See *id.*; Rev. Rul. 58-515, 1958-2 C.B. 28.

<sup>176</sup> Rev. Rul. 58-515, 1958-2 C.B. 28.

<sup>177</sup> See *id.*

<sup>178</sup> See *id.*

<sup>179</sup> See *id.*

appointed representation of indigent clients because they turned fees over to the legal aid society.<sup>180</sup> The IRS again based its decision on the agency theory, reasoning that the lawyers received the assigned income as agents for the legal aid society and realized no personal gain from payment for their services.<sup>181</sup> An agency relationship was found even though the courts issued payments directly to the attorneys and had no dealings with the legal aid society.<sup>182</sup>

### III. FLAWED RESULTS IN VOW-OF-POVERTY CASES

In the vow-of-poverty cases, the circuit courts misapplied the U.S. Supreme Court precedents by analyzing them under the standard in *Lucas v. Earl* rather than under the exception created in *Poe v. Seaborn*.<sup>183</sup> Subsequent application of the agency theory in vow-of-poverty cases violated horizontal equity by treating differently members who work for affiliated organizations and those who work for unaffiliated employers,<sup>184</sup> as well as by applying a less stringent agency theory in comparable non-religious assignments.<sup>185</sup>

#### A. Misapplication of U.S. Supreme Court Precedent in Vow-of-Poverty Cases

The law governing assignment of income from personal services was shaped in the context of marriage.<sup>186</sup> It is thus fitting to examine how vow-of-poverty cases fit with these core doctrinal cases.<sup>187</sup> The basic issue is whether assignment of income from a member to a religious order pursuant to a vow of poverty is more akin to the assignment of half of the husband's income to his wife in *Earl*, where assignment was disallowed, or to a similar assignment in a community property state in *Seaborn*, where assignment was proper.<sup>188</sup> Courts have improperly aligned vow-of-poverty cases with *Earl* when in fact these cases are more similar to

<sup>180</sup> Rev. Rul. 65-282, 1965-2 C.B. 21.

<sup>181</sup> *Id.*

<sup>182</sup> *See id.*

<sup>183</sup> *See* *Schuster v. Comm'r*, 800 F.2d 672, 679 (7th Cir. 1986); *Fogarty v. United States*, 780 F.2d 1005, 1009-10 (Fed. Cir. 1986). *Compare* *Poe v. Seaborn*, 282 U.S. 101, 109 (1930), *with* *Lucas v. Earl*, 281 U.S. 111, 113-14 (1930).

<sup>184</sup> *Compare, e.g., Schuster*, 800 F.2d at 678, *with* Rev. Rul. 77-290, 1977-2 C.B. 26.

<sup>185</sup> *Compare, e.g., Kircher v. United States*, 872 F.2d 1014, 1019 (Fed. Cir. 1989), *with* Rev. Rul. 65-282, 1965-2 C.B. 21.

<sup>186</sup> *See* *Comm'r v. Harmon*, 323 U.S. 44, 44-45 (1944); *Seaborn*, 282 U.S. at 109; *Earl*, 281 U.S. at 113-14.

<sup>187</sup> *See Kircher*, 872 F.2d at 1019; *Schuster*, 800 F.2d at 678; *Fogarty*, 780 F.2d at 1008.

<sup>188</sup> *See Seaborn*, 282 U.S. at 118; *Earl*, 281 U.S. at 114-15.

*Seaborn*.<sup>189</sup> In essence, courts have misapplied the core cases dealing with assignment of income when considering assignments pursuant to vows of poverty.<sup>190</sup>

In *Earl*, the husband assigned half of his earnings to his wife pursuant to a contract between the two spouses.<sup>191</sup> Despite the fact that the contract was enforceable under state law, the U.S. Supreme Court held that the assignment was inconsequential for tax purposes, rendering the husband liable to pay tax on his full earnings.<sup>192</sup> Unlike in *Earl*, where the assignment of income arose not from the relationship between the assignor and assignee but from an independent arrangement, when a priest or nun assigns income to a religious order, the assignment stems from the very glue that holds the relationship together—the vow of poverty.<sup>193</sup> This distinction went unnoticed in *Fogarty v. United States*, where the U.S. Court of Appeals for the Federal Circuit in 1986 held that a Jesuit priest's earnings were fully taxable even though he had assigned his salary as a university professor to his order pursuant to a vow of poverty.<sup>194</sup> Putting aside personal preferences, formal division of income and its tax consequences were not integral to Mr. and Mrs. Earl's marriage, given that the institution of marriage can remain viable without assignment of income.<sup>195</sup> On the other hand, Father Fogarty could not have remained a member of his Jesuit order if he had refused to assign his earnings to the order, as his membership in the order was contingent upon his renunciation of material belongings.<sup>196</sup> Hence, his assignment of income to the order was by no means a type of "anticipatory arrangement" the Court in *Earl* sought to prevent from having tax effects.<sup>197</sup>

The circumstances in vow-of-poverty cases like *Fogarty* bear stronger similarity to *Seaborn*, where a husband and wife living in a community property state each reported one half of the husband's income on their separate tax returns.<sup>198</sup> The Supreme Court held that assignment of income was a necessary consequence of the operation of state law, reason-

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<sup>189</sup> See *Kircher*, 872 F.2d at 1019; *Schuster*, 800 F.2d at 679; *Fogarty*, 780 F.2d at 1009–10.

<sup>190</sup> See *Kircher*, 872 F.2d at 1019; *Schuster*, 800 F.2d at 679; *Fogarty*, 780 F.2d at 1009–10.

<sup>191</sup> 281 U.S. at 113–14.

<sup>192</sup> *Id.* at 114–15.

<sup>193</sup> See *Earl*, 281 U.S. at 113–14; *Schuster*, 800 F.2d at 673; *Fogarty*, 780 F.2d at 1007.

<sup>194</sup> See 780 F.2d at 1013.

<sup>195</sup> See *Earl*, 281 U.S. at 113–14.

<sup>196</sup> See *Order of St. Benedict of N.J. v. Steinhauser*, 234 U.S. 640, 644–45 (1914); *Fogarty*, 780 F.2d at 1007.

<sup>197</sup> See *Earl*, 281 U.S. at 115; *Fogarty*, 780 F.2d at 1007.

<sup>198</sup> See *Seaborn*, 282 U.S. at 109; *Fogarty*, 780 F.2d at 1007.

ing that any potential income of either spouse belonged to the marital community rather than to the individual spouse.<sup>199</sup> Similar logic applies to assignment pursuant to a vow of poverty because ownership rights between a religious order and its members emanate from the legal status of their relationship.<sup>200</sup> According to the Supreme Court's reasoning in the 1914 case of *Order of St. Benedict of New Jersey v. Steinhauser*, a vow of poverty has the legal effect of transferring all present and future property of the person who takes the vow to his or her religious order.<sup>201</sup> This condition of membership—that future income belongs to the order and not the member—renders vow-of-poverty cases more similar to cases involving a marital relationship in a community property state, where the fact of marriage mandates that future earnings will belong to each spouse equally.<sup>202</sup> When concluding in *Fogarty* that the Supreme Court's reasoning in *Seaborn* does not apply to vow-of-poverty cases because they merely involve canonical rights enforceable in civil courts, the Federal Circuit failed to appreciate the ramifications of *Steinhauser*.<sup>203</sup> The Supreme Court emphasized in *Steinhauser* that ownership rights between the priest and his order pursuant to vows of poverty are legally enforceable not because of church law, but because of the legal relationship created by the order's state-granted corporate charter.<sup>204</sup> In both *Seaborn* and *Fogarty*, then, establishing an arrangement that divests the taxpayer of his income and assigns it to another entity is a prerequisite to the relationship created through state law.<sup>205</sup>

The U.S. Supreme Court's third application of assignment of income doctrine in the context of marriage in 1944 in *Commissioner v. Harmon* strengthens the applicability of *Seaborn* to vow-of-poverty cases.<sup>206</sup> The facts of *Harmon* are almost identical to *Seaborn*: a husband assigned half of his income to his wife in a community property state.<sup>207</sup> The crucial difference is that in *Harmon* the community property law applied only to those spouses who opted into the system.<sup>208</sup> Due to the

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<sup>199</sup> See *Seaborn*, 282 U.S. at 117.

<sup>200</sup> See *id.*; *Steinhauser*, 234 U.S. at 644–45.

<sup>201</sup> See *Steinhauser*, 234 U.S. at 644–45.

<sup>202</sup> See *Seaborn*, 282 U.S. at 117; *Steinhauser*, 234 U.S. at 644–45.

<sup>203</sup> See *Steinhauser*, 234 U.S. at 644–45; *Fogarty*, 780 F.2d at 1009.

<sup>204</sup> See 234 U.S. at 648.

<sup>205</sup> See *Seaborn*, 282 U.S. at 117; *Fogarty*, 780 F.2d at 1009.

<sup>206</sup> See *Harmon*, 323 U.S. at 46–47; *Seaborn*, 282 U.S. at 117.

<sup>207</sup> See *Harmon*, 323 U.S. at 44–45; *Seaborn*, 282 U.S. at 109.

<sup>208</sup> See *Harmon*, 323 U.S. at 44–45.

voluntary nature of joint ownership, the Court held that the husband's income was non-assignable for tax purposes.<sup>209</sup>

Vow-of-poverty cases like *Fogarty* are more akin to *Seaborn* than *Harmon* because the renunciation of present and future property and income pursuant to a vow of poverty is mandatory of all members of religious orders.<sup>210</sup> Although members voluntarily elect to join religious orders and take vows of poverty, this is no different from couples voluntarily deciding to marry.<sup>211</sup> The point of contention is not whether the decision to enter into a relationship, whether marital or monastic, is voluntary, but whether property ownership characteristics of that relationship are optional or obligatory under state law.<sup>212</sup> Viewed in this light, it is apparent that unlike the opt-in nature of community property law in *Harmon*, there is nothing voluntary about the requirement that a member transfer all of his or her property interests to his or her religious order.<sup>213</sup>

Hence, an examination of the core doctrinal cases on assignment of personal service income shows that in cases involving assignment of income in compliance with vows of poverty, the two circuit courts of appeals misapplied the doctrine.<sup>214</sup> The Supreme Court's reasoning in *Earl*, *Seaborn*, and *Harmon* stands for the proposition that when state law mandates assignment of income as part and parcel of a legally recognized relationship, the wage earner is not subject to tax on the assigned income.<sup>215</sup> Father Fogarty, like other members of religious orders who must transfer their earnings to their orders, should not be required to pay tax on income that was never his.<sup>216</sup>

#### B. Agency Theory's Flawed Distinctions Between Similarly Situated Taxpayers

For nearly sixty years the IRS allowed all members of religious orders who assigned earned income to their orders to avoid paying tax on the theory that they received that income as agents of their orders.<sup>217</sup> The IRS and the courts then used the same agency theory to apply a

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<sup>209</sup> See *id.* at 47.

<sup>210</sup> See *Steinhauser*, 234 U.S. at 644–45; *Fogarty*, 780 F.2d at 1009.

<sup>211</sup> See *Harmon*, 323 U.S. at 53 (Douglas, J., dissenting).

<sup>212</sup> See *id.* at 47–48 (majority opinion); *Seaborn*, 282 U.S. at 117; *Fogarty*, 780 F.2d at 1009.

<sup>213</sup> See *Harmon*, 323 U.S. at 44; *Steinhauser*, 234 U.S. at 644–45.

<sup>214</sup> See *Harmon*, 323 U.S. at 46; *Seaborn*, 282 U.S. at 117; *Earl*, 281 U.S. at 114–15; *Fogarty*, 780 F.2d at 1009.

<sup>215</sup> See *Harmon*, 323 U.S. at 47–48; *Seaborn*, 282 U.S. at 117; *Earl*, 281 U.S. at 114–15.

<sup>216</sup> *Contra Fogarty*, 780 F.2d at 1007.

<sup>217</sup> See *supra* notes 96–99 and accompanying text.

stricter standard that in essence requires a contractual relationship between the order and the outside employer and requires the order to maintain daily control over the member in order for his earnings to qualify as the earnings of an agent.<sup>218</sup> It is difficult to imagine a set of circumstances where such level of control would be satisfied consistent with the nature of outside employment, given that even the facts in *Kircher v. United States* did not satisfy it; in that case, the hospitals did not exercise day-to-day supervision over the chaplains and any meaningful supervision was conducted by their religious orders.<sup>219</sup> On the other hand, in comparable non-religious contexts, the agency theory has been used to allow assignors to avoid tax liability even when there is no contract between the principal and the outside employer and the principal lacks control over the purported agent's daily activities.<sup>220</sup> The inconsistency shows that the agency theory as applied is problematic because similarly situated taxpayers are being treated differently.<sup>221</sup>

### 1. Employment Inside Versus Outside the Religious Order

Perhaps the most obvious difference in tax treatment of members who assign their personal service income to their orders is between those members who work "inside" the order and those who work for an "outside" employer.<sup>222</sup> When a member of a religious order works for his or her church or an affiliated institution and assigns income earned to the order, the IRS has ruled that the member is acting as an agent of the order and thus assigned income is not taxable to the member.<sup>223</sup> In Revenue Ruling 77-290, the IRS ruled that a nun who worked as a secretary at the business office of the church and assigned her earnings to the order acted as an agent for her order and thus did not have to include the assigned earnings in her gross income.<sup>224</sup> The IRS argued successfully, however, in the 1986 7th Circuit case of *Schuster v. Commissioner* that a nun who worked with her order's permission as a midwife at a clinic in an impoverished area and endorsed all her paychecks to

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<sup>218</sup> See *Kircher*, 872 F.2d at 1019; *Schuster*, 800 F.2d at 678; *Fogarty*, 780 F.2d at 1008.

<sup>219</sup> See *Kircher*, 872 F.2d at 1017-18.

<sup>220</sup> See, e.g., Rev. Rul. 65-282, 1965-2 C.B. 21; Rev. Rul. 58-515, 1958-2 C.B. 28.

<sup>221</sup> See *Kircher*, 872 F.2d at 1019; *Schuster*, 800 F.2d at 678; *Fogarty*, 780 F.2d at 1013; Rev. Rul. 65-282, 1965-2 C.B. 21; Rev. Rul. 58-515, 1958-2 C.B. 28.

<sup>222</sup> See *Schuster*, 800 F.2d at 678; Rev. Rul. 77-290, 1977-2 C.B. 26.

<sup>223</sup> Rev. Rul. 77-290, 1977-2 C.B. 26.

<sup>224</sup> See *id.* at 28.

her order was not acting as an agent of her order and thus had to pay tax on her salary.<sup>225</sup>

Despite the divergent treatment of the two nuns, there are not many practical differences between their two situations.<sup>226</sup> Both are working with their respective orders' consent in an area affiliated with common religious missions: one is providing necessary administrative services for a church, and the other is providing health care in an underserved area.<sup>227</sup> Both are working for their respective employers at the will of the orders, bound by vows of obedience to terminate their employment at the orders' direction.<sup>228</sup> Both are bound by their vows of poverty to assign every cent earned to their orders.<sup>229</sup> Yet one nun is liable to pay tax on income that was never hers to retain, and the other nun bears no tax liability.<sup>230</sup>

It is unclear why a religious affiliation between the employer and the order should affect the determination of whether a member is acting in his or her individual capacity or as an agent for the order.<sup>231</sup> Focusing on religious affiliation creates horizontal inequality because two taxpayers in substantially similar situations receive vastly different tax treatment.<sup>232</sup> Moreover, although the Seventh Circuit in *Schuster* claimed to apply a functional, multifactorial approach to determine agency, it in fact treated day-to-day control and the name on the paycheck as the *sine qua non* of a principal-agent relationship.<sup>233</sup> The Seventh Circuit thus effectively foreclosed members who work for outside employers from being considered agents of their orders for purposes of federal income taxation if there is no contract between the order and the outside employer.<sup>234</sup> For all intents and purposes, the holding of *Schuster* has the same practical effects as the Commissioner's original stance that only those members whose order contracts directly with the employer for their services would be able to exclude income from taxation upon its assignment to the order.<sup>235</sup>

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<sup>225</sup> See 800 F.2d at 679.

<sup>226</sup> See *Schuster*; 800 F.2d at 678; Rev. Rul. 77-290, 1977-2 C.B. 26.

<sup>227</sup> See *Schuster*; 800 F.2d at 674; Rev. Rul. 77-290, 1977-2 C.B. 26.

<sup>228</sup> See *Schuster*; 800 F.2d at 675; Rev. Rul. 77-290, 1977-2 C.B. 26.

<sup>229</sup> See *Schuster*; 800 F.2d at 675; Rev. Rul. 77-290, 1977-2 C.B. 26.

<sup>230</sup> See *Schuster*; 800 F.2d at 678; Rev. Rul. 77-290, 1977-2 C.B. 26.

<sup>231</sup> See *Schuster*; 800 F.2d at 678; Rev. Rul. 77-290, 1977-2 C.B. 26.

<sup>232</sup> See Cordes, *supra* note 12, at 165.

<sup>233</sup> See 800 F.2d at 679.

<sup>234</sup> See *id.*

<sup>235</sup> See *id.*

## 2. Nun Employed Outside the Order Versus Covert Police Officer

The agency theory, as applied by the IRS and the courts, can be criticized on many grounds.<sup>236</sup> Notably, the agency theory as applied is diametrically opposed to the IRS rulings in similar circumstances.<sup>237</sup> If the agency theory as applied to vow-of-poverty cases was applied consistently with the IRS rulings, their outcomes would almost certainly be different.<sup>238</sup> As shown in the next two subsections, divergent outcomes are manifestations of the incompatibility of the agency theory with cases involving assignment of income.<sup>239</sup>

In Revenue Ruling 58-515, the IRS ruled that an undercover police officer who worked for an outside employer during a covert operation and turned over his earnings to the police department could not be taxed on the assigned income.<sup>240</sup> Without addressing any of the factors required under the agency theory in *Fogarty* and *Schuster*, the IRS found that the undercover officer was employed as an agent of the police department.<sup>241</sup> Nonetheless, Sister Schuster was held not to be an agent of her order when she worked as a midwife at a low-income clinic at the direction of her order.<sup>242</sup> Though the facts of the two cases may mask their actual similarity, application of the agency theory reveals deep inconsistencies, making the undercover officer an even less likely agent than Sister Schuster.<sup>243</sup>

Agency theory boils down to an inquiry into whether the purported principal is maintaining day-to-day control over the agent's activities, whether there is sufficient interaction between the employer and the principal, and whether the agent or principal's name is on the payroll check.<sup>244</sup> In *Schuster*, the order exercised significant control over the conditions of the nun's employment, including requiring her to refuse to supply contraceptives and conditioning her employment with the clinic on continued compliance with the order's mission.<sup>245</sup> It was the clinic and not the order, however, that exercised more day-to-day control over the actual performance of her duties as a midwife.<sup>246</sup> Simi-

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<sup>236</sup> See, e.g., *id.* at 680–81 (Cudahy, J., dissenting).

<sup>237</sup> See, e.g., Rev. Rul. 65-282, 1965-2 C.B. 21; Rev. Rul. 58-515, 1958-2 C.B. 28.

<sup>238</sup> See *Schuster*, 800 F.2d at 678; *Fogarty*, 780 F.2d at 1013.

<sup>239</sup> See *Schuster*, 800 F.2d at 678; *Fogarty*, 780 F.2d at 1013.

<sup>240</sup> Rev. Rul. 58-515, 1958-2 C.B. 28.

<sup>241</sup> See *supra* notes 176–179 and accompanying text.

<sup>242</sup> See *Schuster*, 800 F.2d at 678.

<sup>243</sup> See *id.*; Rev. Rul. 58-515, 1958-2 C.B. 28.

<sup>244</sup> See *Schuster*, 800 F.2d at 678; *Fogarty*, 780 F.2d at 1008.

<sup>245</sup> See *Schuster*, 800 F.2d at 680–81 (Cudahy, J., dissenting).

<sup>246</sup> See *id.* at 679 (majority opinion).

larly, though the police department undoubtedly directed the undercover officer's participation in the employer's business, it was the private employer who had greater control over the officer's daily work activities.<sup>247</sup> Moreover, as both Sister Schuster and the police officer received paychecks in their names, they technically had control over the income received.<sup>248</sup>

Although, thus far, both Sister Schuster and the police officer appear equally unlikely to qualify as agents, the fact that Sister Schuster's principal had far more interaction with her employer indicates that Sister Schuster is a step ahead.<sup>249</sup> Although the clinic contracted with Sister Schuster for her services and not with her order, the clinic was aware that she was a nun who pursuant to her vow of poverty needed to assign all her income to the order, and the clinic corresponded with the order to confirm Sister Schuster's employment.<sup>250</sup> Even so, the Federal Circuit emphasized the lack of formal arrangement between the order and the clinic in holding that Sister Schuster was acting in her individual capacity, rather than as an agent of the order.<sup>251</sup> On the other hand, in Revenue Ruling 58-515, there was *no* interaction between the private employer and police officer's purported principal, the police department.<sup>252</sup> In fact, given the covert nature of the operation, the employer did not even know its employee was a police officer.<sup>253</sup>

Therefore, application of the agency theory, as developed in vow-of-poverty cases, would change the outcome in the IRS's own ruling in a related assignment of income context.<sup>254</sup> The contrast between the two holdings demonstrates how inconsistent use of the agency theory has unfairly resulted in two similarly situated taxpayers receiving different tax treatment.<sup>255</sup> Ironically, the agency theory appears more viable in Sister Schuster's case, but it is the police officer who received tax benefits as an agent.<sup>256</sup> Although it may be wise as a policy matter to treat a police officer as an agent of the police department, a straightforward application of the agency theory would not allow for such treatment because the outside employer was unaware even of the prin-

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<sup>247</sup> See Rev. Rul. 58-515, 1958-2 C.B. 28; Jensen, *supra* note 52, at 651.

<sup>248</sup> See *Schuster*; 800 F.2d at 679; Rev. Rul. 58-515, 1958-2 C.B. 28.

<sup>249</sup> See *Schuster*; 800 F.2d at 674-75.

<sup>250</sup> See *id.*

<sup>251</sup> See *id.* at 678.

<sup>252</sup> See Rev. Rul. 58-515, 1958-2 C.B. 28.

<sup>253</sup> See *id.*

<sup>254</sup> See *Schuster*; 800 F.2d at 678-79; Rev. Rul. 58-515, 1958-2 C.B. 28.

<sup>255</sup> See *Schuster*; 800 F.2d at 678; Rev. Rul. 58-515, 1958-2 C.B. 28.

<sup>256</sup> See *Schuster*; 800 F.2d at 678; Rev. Rul. 58-515, 1958-2 C.B. 28.

cial's existence.<sup>257</sup> Instead of ruling that the decision was an outcome of the agency theory, the IRS could have framed the case as an exception to the agency theory, but it chose not to do so.<sup>258</sup> The inconsistent result remains a strong argument against the agency theory's application to the vow-of-poverty cases.<sup>259</sup>

### 3. Priest Employed as Hospital Chaplain Versus Legal Aid Lawyer

The divergence between two similar cases purporting to apply the same agency theory—illustrated by comparing *Schuster* and Revenue Ruling 58-515—is not an exception but the norm.<sup>260</sup> The pattern of paying lip service to the agency theory in a non-religious context yet stringently applying it in vow-of-poverty cases is easily identified in other holdings as well.<sup>261</sup>

In Revenue Ruling 65-282, the IRS ruled that court fees received by a legal aid society's lawyers and assigned to the legal aid society yielded no tax liability for the lawyers.<sup>262</sup> Without supplying even minimal explanation, the ruling stated that the lawyers were acting as agents and did not personally benefit from the payments.<sup>263</sup> On the other hand, when the Federal Circuit decided *Kircher*, the IRS successfully argued that priests whom the order appointed to chaplaincy positions in hospitals were not agents of their order.<sup>264</sup>

The agency theory, though emphasized in both cases as the applicable rule, cannot explain such inconsistent results.<sup>265</sup> Although the Federal Circuit in *Kircher* determined that there was no agency relationship because there was no contractual arrangement between the hospitals and the religious order, the lack of such a contract between the legal aid society and the order in Revenue Ruling 65-282 did not prevent

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<sup>257</sup> See *Schuster*, 800 F.2d at 678–79; Rev. Rul. 58-515, 1958-2 C.B. 28.

<sup>258</sup> See Rev. Rul. 58-515, 1958-2 C.B. 28.

<sup>259</sup> See *Schuster*, 800 F.2d at 679; Rev. Rul. 58-515, 1958-2 C.B. 28. Professor Jensen also criticizes the agency theory for its lack of consistent results. Jensen, *supra* note 52, at 651. He rejects the agency theory in favor of following per se rules. *Id.* at 658. In cases involving gratuitous assignments of income, such as assignments from members to their religious orders, the income should be taxed to the wage earner. *Id.* In cases involving assignments for consideration, where the assignor receives something of value in return for the assignment, the wage earner should be taxed on the consideration he received but not on the assigned income. *Id.*

<sup>260</sup> See, e.g., *Kircher*, 872 F.2d at 1019–20; Rev. Rul. 65-282, 1965-2 C.B. 21.

<sup>261</sup> See *Kircher*, 872 F.2d at 1019–20; Rev. Rul. 65-282, 1965-2 C.B. 21.

<sup>262</sup> Rev. Rul. 65-282, 1965-2 C.B. 21.

<sup>263</sup> See *id.*

<sup>264</sup> See *Kircher*, 872 F.2d at 1019.

<sup>265</sup> See *id.*; Rev. Rul. 65-282, 1965-2 C.B. 21.

the IRS from finding an agency relationship.<sup>266</sup> Furthermore, the employers in both cases paid earnings directly to the employees rather than the supposed principals.<sup>267</sup> Finally, there was no evidence that the legal aid society had more daily control over the lawyers while they earned their court fees than the order exercised over the priests in their chaplaincy positions.<sup>268</sup>

In practical terms, *Kircher* was a stronger candidate for agency theory than either *Fogarty* or *Schuster*; given that in *Kircher* the outside employers had established relationships with the order by looking to it to appoint chaplaincy candidates.<sup>269</sup> Although it is true that the hospitals made the ultimate decisions whether to hire the candidates put forth by the order, the hospitals relied on the recommendation of the order supplying the candidates in making the decision whether to hire the chaplains.<sup>270</sup> Yet, even this arrangement could not survive the tough requirements of the agency theory that apparently apply exclusively to assignments pursuant to vows of poverty.<sup>271</sup>

#### IV. REESTABLISHING HORIZONTAL EQUITY WITH THE *GLENSHAW GLASS* REQUIREMENT OF DOMINION AND CONTROL

Given that the application of agency theory in vow-of-poverty cases is inconsistent with results in other cases involving assignment of income,<sup>272</sup> the question arises as to how to solve the problem. One option is to modify the agency theory along the lines illustrated by Judge Cudahy in his dissent in the 7th Circuit's 1986 decision in *Schuster v. Commissioner*.<sup>273</sup> Such a multifactorial test, however, invites inconsistency.<sup>274</sup> This Note advocates for an alternative approach: courts should avoid the flawed agency theory altogether and instead evaluate assignment of personal service income cases under the dominion and control standard of the U.S. Supreme Court's 1955 decision in *Commissioner v.*

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<sup>266</sup> See *Kircher*, 872 F.2d at 1019; Rev. Rul. 65-282, 1965-2 C.B. 21.

<sup>267</sup> See *Kircher*, 872 F.2d at 1016-17; Rev. Rul. 65-282, 1965-2 C.B. 21.

<sup>268</sup> See *Kircher*, 872 F.2d at 1016-17; Rev. Rul. 65-282, 1965-2 C.B. 21; see also Jensen, *supra* note 52, at 653 (arguing that *Kircher* and a revenue ruling involving a law school's clinical faculty cannot be distinguished on the basis of the assignor's amount of control over daily activities of the assignee).

<sup>269</sup> See *Kircher*, 872 F.2d at 1016.

<sup>270</sup> See *id.* at 1017.

<sup>271</sup> See *id.* at 1019-20.

<sup>272</sup> See *supra* notes 183-273 and accompanying text.

<sup>273</sup> See 800 F.2d 672, 682 (7th Cir. 1986) (Cudahy, J., dissenting).

<sup>274</sup> See *Comm'r v. Glenshaw Glass Co.*, 348 U.S. 426, 431 (1955).

*Glenshaw Glass Co.*<sup>275</sup> Given that this proposed solution would resolve the inconsistent application of the agency theory and ensure horizontal equity, the U.S. Supreme Court should adopt it and end the improper taxation of the vowed religious.<sup>276</sup>

In *Glenshaw Glass*, gross income is defined as any accession to wealth, clearly realized, over which the taxpayer has complete dominion and control.<sup>277</sup> If the taxpayer has no right or ability to exercise dominion and control over the income, then such income is excluded from the formula that calculates the taxpayer's tax liability.<sup>278</sup> Taken in the context of assignment of income cases, the IRS and the courts would avoid the tangled webs of agency theory by asking whether the assignor at any point had ultimate direction over the earnings or control over its assignment.<sup>279</sup> If such control belongs to the taxpayer who earns the income, then the amount is properly included in his gross income and is thus taxable.<sup>280</sup> Subsequent assignment of control over that earned income to a third party would bear no tax consequences.<sup>281</sup> If the taxpayer, however, is in a legally cognizable relationship whose very existence *a priori* vests dominion and control over his or her earned income in another entity, the fact that the taxpayer earned the income is irrelevant.<sup>282</sup>

In cases like *Schuster*, and the Federal Circuit's 1986 decision *Fogarty v. United States* and 1989 decision in *Kircher v. United States*, where individuals become members of religious orders by taking vows of poverty, legally renouncing claims to any current or future property, and assigning to the orders all earnings from services performed for outside employers, they lack dominion and control over those earnings.<sup>283</sup> Similarly, undercover police officers, like the officer in Revenue Ruling 74-581, who work for a private employer in a sting operation but assign earnings to the police department in accordance with an employment agreement never have actual dominion and control over such income.<sup>284</sup> In both contexts, it is irrelevant whether a paycheck is in name

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<sup>275</sup> See *id.*

<sup>276</sup> See *id.*

<sup>277</sup> *Id.*

<sup>278</sup> See *id.*

<sup>279</sup> See *id.*

<sup>280</sup> See *Glenshaw Glass*, 348 U.S. at 431.

<sup>281</sup> See *id.*

<sup>282</sup> See *id.*

<sup>283</sup> See *Kircher v. United States*, 872 F.2d 1014, 1019-20 (Fed. Cir. 1989); *Schuster*, 800 F.2d at 678-79; *Fogarty v. United States*, 780 F.2d 105, 1007-08 (Fed. Cir. 1986).

<sup>284</sup> See Rev. Rul. 65-282, 1965-2 C.B. 21.

of the individual or the organization because the organization is entitled to the income.<sup>285</sup>

Nor is the IRS's policy rationale for requiring a strict test of agency theory strong enough to override the benefits of the dominion and control approach.<sup>286</sup> The tax protest cases that prompted the IRS to change the policy on taxation of members of religious orders were instances in which the taxpayers' actions constituted fraud because they had in effect retained control over their earnings.<sup>287</sup> In essence, the assignments to mail order churches were mere paper trails that sought to hide the fact that the taxpayers' financial wealth was the same after the alleged assignment.<sup>288</sup> The IRS could develop less restrictive means to weed out such tax frauds that would not punish members of religious orders who in earnest relinquish their incomes to their orders to comply with their legally enforceable vows of poverty. For example, the IRS could require proof that the religious orders receiving assigned income are established, bona fide religious organizations. Given that such measures would ameliorate concerns about tax fraud, the underlying rationale for applying the inconsistent agency theory is not persuasive.<sup>289</sup>

#### CONCLUSION

One of principle goals of tax policy is to ensure that similarly situated taxpayers receive similar tax burdens. For members of religious orders who assign income to their orders pursuant to a vow of poverty, the IRS and two circuit courts of appeals have applied a formulistic agency theory that makes it virtually impossible for members who work outside their orders to claim exemption from tax without a contract between the order and the outside employer. The application of this same theory in several similar, albeit non-religious, contexts attests to inequitable treatment. To avoid this inequity, courts should address assignment of personal service income cases by asking whether the assignment was within the dominion and control of the taxpayer. Only then will similarly situated taxpayers receive equitable tax treatment.

SAMIRA ALIC OMEROVIC

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<sup>285</sup> See *Kircher*, 872 F.2d at 1019–20; *Schuster*, 800 F.2d at 678–79; *Fogarty*, 780 F.2d at 1007–08; Rev. Rul. 65-282, 1965-2 C.B. 21.

<sup>286</sup> See *supra* notes 96–107 and accompanying text.

<sup>287</sup> See *supra* notes 96–107 and accompanying text.

<sup>288</sup> See, e.g., *Page v. Comm'r*, 51 T.C.M. (CCH) 1351, 1352 (1986); *McGahen v. Comm'r*, 76 T.C. 468, 471 (1981).

<sup>289</sup> See *supra* notes 96–107 and accompanying text.

