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Tax-Exempt Financing of Churches, Parochial Schools and Other Sectarian Institutions After Trinity Lutheran Church: Permitted? Required? Let us Pray for Answers

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The U.S. Supreme Court's June 26 opinion *in Trinity Lutheran Church of Columbia, Inc*. v. *Comer*, precluding states from discriminating against churches in at least some state financing programs, raises anew the question of whether states may, or are required to, provide tax-exempt conduit bond financing to churches and other sectarian institutions. The Supreme Court's decision further complicates an already complicated analysis of that question by bond counsel, and in some instances may tip bond counsel's answer in favor of green-lighting tax-exempt financing of some capital projects of sectarian institutions.

The First Amendment to the U.S. Constitution precludes Congress and, via the Fourteenth Amendment, states from legislating the establishment of religion (the "Establishment Clause"), or prohibiting the free exercise thereof (the "Free Exercise Clause"). Under a line of Supreme Court cases that has been cast into doubt but never expressly repudiated by a majority of the U.S. Supreme Court, the Establishment Clause has been held to prohibit state financing of "pervasively sectarian" institutions, i.e. institutions that "are so 'pervasively sectarian' that secular activities cannot be separated from sectarian ones." *Roemer* v. *Board of Publ. Works of Maryland (1976).*

The Supreme Court has questioned whether tax-exempt conduit bond financings constitute state financings for purposes of the Establishment Clause. In *Hunt* v. *McNair* (1973), addressing tax-exempt bond financing for a Baptist college, the Court noted: "The 'state aid' involved in this case is of a very special sort. We have here no expenditure of public funds, either by grant or loan, no reimbursement by a State for expenditures made by a parochial school or college, and no extending or committing of a State's credit. Rather, the only state aid consists, not of financial assistance directly or indirectly which would implicate public funds or credit, but the creation of an instrumentality (the Authority) through which educational institutions may borrow funds on the basis of their own credit and the security of their own property upon more favorable interest terms than otherwise would be available." Although the Court upheld the financing for the benefit of the Baptist college, it did so on the basis that the college was not "pervasively sectarian", and thus did not resolve whether tax-exempt conduit financing of a "pervasively sectarian" institution would be permissible.

In 2002, the Sixth Circuit Court of Appeals in *Steele v. Industrial Development Board of Metropolitan Government Nashville* addressed the question left unanswered by the Supreme Court favorably to David Lipscomb University, which was deemed "pervasively sectarian" for purposes of the court's analysis. The Sixth Circuit held: "[T]he nature of the institution is not the relevant inquiry in the special type of aid at issue in this appeal. The nature of the aid conferred by the tax free revenue bonds is not direct aid. Instead, it is analogous to an indirect financial benefit conferred by a religiously neutral tax or charitable deduction..,. The funding vehicle is available on a neutral basis. No government funds will be expended. …. The benefit to be obtained by Lipscomb University is the same provided to private companies which create identical economic opportunities. The conduit financing advances a clear governmental, secular interest in promoting economic opportunity. Finally, the revenue bond program does not present the perception of government endorsement of religion."

The Sixth Circuit decision in *Steele* has not resolved the question of whether tax-exempt conduit financing is immune from the Establishment Clause. Under the industry standard established by the National

Association of Bond Lawyers, in order to render the "unqualified" opinion required in municipal bond transactions, bond counsel must be "firmly convinced or ha[ve] a high degree of confidence that, under the law in effect on the date of the opinion, the highest court of the relevant jurisdiction, acting reasonably and properly briefed on the issues, would reach the legal conclusions stated in the opinion." On First Amendment questions, the highest court of the relevant jurisdiction is the United States Supreme Court. While the Supreme Court's hint in *Hunt* v. *McNair* might suggest that it would endorse the Sixth Circuit's analysis if asked to decide the matter, the Supreme Court has not held that tax-exempt conduit financing is a type of state financing not subject to the Establishment Clause.

The *Trinity Lutheran Church* decision whittles away at the wall between church and state insofar as state financing of churches is concerned, and may prompt bond counsel to approve some types of conduit financing for "pervasively sectarian" institutions that they would not have approved previously. However, it is likely to be interpreted by many bond counsel as falling short of providing the "high degree of confidence" required for a bond opinion to the effect that tax-exempt conduit financing of a pervasively sectarian institution is generally permissible.

At issue in *Trinity Lutheran Church* is a Missouri program providing direct state aid, in the form of grants. to nonprofit institutions for the purpose of making playgrounds safer. Missouri's constitution precludes state aid to churches and sectarian institutions. Accordingly, Trinity Lutheran Church's application for a grant was rejected. The Supreme Court's ruling invalidates the Missouri constitution's "anti-aid" provision as applied to such playground improvement grants. Notably, the parties to the litigation assumed that a direct state grant to the church would have been permissible under the Establishment Clause if Missouri had authorized such grants, and the Supreme Court opinion does not analyze the case under the Establishment Clause. Instead, the case focuses on the Free Exercise Clause, holding that Missouri is required to make such grants available to a church on the same terms as they were available to other nonprofit entities.

The holding that a state is constitutionally required to provide direct aid to churches in some instances is a momentous one in First Amendment jurisprudence. The Supreme Court leaves the breadth of its holding unclear, however, and that lack of clarity will continue to bedevil the availability of tax-exempt financing for religious institutions.

Chief Justice Roberts's majority opinion in *Trinity Lutheran Church* distinguishes a prior Supreme Court case, *Locke* v. *Davey* (2004), in which the Supreme Court upheld a State of Washington scholarship program that precluded use of the scholarships to pursue a devotional theology degree. Per the *Trinity Lutheran Church* majority opinion, "Washington's restriction on the use of its scholarship funds was different [from the Missouri grant program.]. According to the Court, the State had 'merely chosen not to fund a distinct category of instruction.' … Davey was not denied a scholarship because of who he was; he was denied a scholarship because of what he proposed to do—use the funds to prepare for the ministry. Here there is no question that Trinity Lutheran was denied a grant simply because of what it is—a church."

This "status/use" distinction is further emphasized in footnote 3 of Chief Justice Roberts's opinion, which, unlike the rest of his opinion, did not garner majority support. According to that footnote: "This case involves express discrimination based on religious identity with respect to playground resurfacing. We do not address religious uses of funding or other forms of discrimination." In a concurring opinion, Justice Gorsuch, joined by Justice Thomas, questions the utility and stability of drawing a distinction "between laws that discriminate on the basis of religious *status* and religious *use*" and stated that "the general principles here do not permit discrimination against religious exercise – whether on the playground or anywhere else."

Where then does *Trinity Lutheran Church* leave tax-exempt conduit bond financing of churches and other "pervasively sectarian" institutions? It remains a vexing and unresolved topic, but the contours have become somewhat clearer. The "easiest" case may be a state statute that provides for conduit financing of, for example, schools. Under *Trinity Lutheran Church,* it appears that even a "pervasively sectarian" school must be permitted access to such conduit financing on equal terms with other schools, at least for portions of the school that clearly do not involve religious indoctrination, e.g. kitchens, bathrooms, athletic facilities. As suggested by Justice Gorsuch's concurring opinion, that line blurs rapidly – is a new roof that covers a building in which sectarian instruction occurs used for sectarian instruction? An HVAC system in such a building? What about a classroom in which bible studies and home economics are taught –must a prorated portion of the cost of constructing such a classroom be financed if the school so requests? Justice Sotomayor's dissent captures the difficult or impossible parsing that the majority opinion appears to require: "The church has a religious mission, one that it pursues through its learning center. The playground surface cannot be confined to secular use any more than lumber used to frame the church's walls, glass stained and used to form its windows, or nails used to build its altar."

Trinity Lutheran Church's "status/use" distinction may also prove problematic in interpreting statutes not drafted with such distinction in mind. The majority opinion suggests that a statute that precludes financing for churches because they are churches is unconstitutional, whereas a statute that precludes financing of religious functions may not be. If a statute simply excludes sectarian schools without distinguishing between facilities used for sectarian purposes and facilities that are not inherently used for sectarian instruction or sectarian practices, is financing required to be made available for sectarian portions of the school? Or can a court infer a legislative intent not to finance the "uses" that would

constitute “religious use” under Roberts’s footnote 3? Good luck to bond counsel in navigating these distinctions.

Bond counsel also will need to grapple with the difference between exclusion and non-inclusion. A statute that authorizes conduit financings for nonprofit institutions other than churches, for example, would seem constitutionally suspect under *Trinity Lutheran Church.* Again, at a minimum, a church seeking tax-exempt financing of its kitchen, bathrooms and other bricks and mortar not used in religious instruction or observance might be constitutionally protected from a denial of access to such financing. A more difficult case may be presented by a statute that affirmatively authorizes conduit financing for certain categories of nonprofit institutions, e.g. healthcare institutions and/or educational institutions, without express exclusion of other categories of nonprofit institutions, such as churches. Does such a statute discriminate against churches in providing financing generally available to nonprofits? Is the existence of other categories of non-included nonprofits, e.g. zoos, sufficient to insulate the statute from a claim of discrimination against churches? Unfortunately, *Trinity Lutheran Church* prompts such questions, without providing answers.

Authors