

**MEMORANDUM**

**TO:** Eric H. Burns and Thomas L. Brooks, Jr.  
**FROM:** Todd W. Ponder  
**DATE:** May 17, 2012  
**RE:** Case Law Dealing with the Establishment Clause

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Introduction

This memorandum is intended to provide assistance to Faith West Properties, Inc. (“Faith West”) in responding to any constitutional questions which may arise in connection with its proposed transaction with the City of West Lafayette, Indiana (the “City”), as described below (the “Transaction”). The memo addresses only the case law dealing with the Establishment Clause of the First Amendment to the United States Constitution.

The Transaction

Faith West has submitted an application to the City in connection with a proposed conduit 501(c)(3) tax-exempt bond issue. The Bonds would be issued by the City pursuant to Indiana Code 36-7-11.9 and 12 (the “Act”). The Project to be financed is comprised of an approximately \$11,640,000 four-story community center to be located at 1920 Northwestern Avenue. Faith West will contribute at least \$4,640,000 of its own funds to the Project. Faith West will use its own funds to pay for the entire first floor of the Project. Faith West will use Bond proceeds, in an amount not to exceed \$7,000,000, to pay for the top three floors of the Project. Those floors will be comprised entirely of apartment/dormitory style housing for local college students or other interested residents.

Under the Internal Revenue Code of 1986, conduit 501(c)(3) revenue bonds must be issued by a state or local governmental entity in order to be considered as tax-exempt. The mechanics of the transaction are straightforward. The City, as the required governmental issuer, will issue Bonds in the amount of \$7,000,000. The Bonds will be sold to a purchaser, in this case JPMorgan Chase (“Chase”). Chase will pay \$7,000,000 for the Bonds. Immediately at closing, the \$7,000,000 in Bond proceeds will be loaned to Faith West. As per the standard bond documents in all such conduit tax-exempt bond transactions, Faith West will then become the sole obligor on a \$7,000,000 loan from Chase. The City will have no responsibility whatsoever (legal or moral) to repay the debt. The debt will effectively become a \$7,000,000 tax-exempt loan directly from Chase to Faith West. Having served its limited role as the required governmental issuer, the City will effectively drop out of the equation after closing. The City

will not expend any funds whatsoever in connection with this process, it will have no responsibility whatsoever to repay the debt, and it will have no ongoing obligations whatsoever to monitor construction or to take any other affirmative actions of any kind.

The business deal between Chase and Faith West will feature a tax-exempt interest rate offered by Chase to Faith West, in recognition of the fact that Chase will not owe income tax on the tax-exempt bonds it has purchased. The Chase loan to Faith West will be further governed by other deal points negotiated directly between Chase and Faith West, including various financial covenants and the like, and including a mortgage of the Project from Faith West in favor of Chase, in order to secure Faith West's sole obligation to repay the \$7,000,000 loan.

The City will not extend any direct benefit or subsidy of any kind to Faith West as a result of its role as conduit issuer in the transaction. As noted, the City will not expend a single dollar on the transaction at closing, or at any time that the Bonds are outstanding, and will likewise not commit a single dollar of present or future tax revenues in support of the Project. The City will be "supporting" the Project only in the sense that it will be lending its name to the transaction as conduit issuer, which will enable Faith West to access the commercial market place of tax-exempt lenders.

Last, it is noteworthy that under the Internal Revenue Code, as well as the Act, any and all 501(c)(3) nonprofit organizations (religious or otherwise) are eligible to pursue and utilize conduit tax-exempt bonds in precisely the fashion described above, in order to finance appropriate economic development capital projects, subject only to the ability of a given 501(c)(3) entity to demonstrate sufficient financial strength to attract interest from potential bond purchasers/lenders.

### Issues Presented

Does the Transaction involve governmental aid to a religious entity? Does the Transaction as proposed run afoul of the Establishment Clause of the First Amendment? To the extent any component element of the Transaction poses such problems, how can that concern be resolved in a favorable way?

### *Executive Summary*

*Both the Internal Revenue Code and the Act are neutral in both purpose and effect with respect to religion, in that the availability of tax-exempt bonds is extended across the spectrum to all manner of nonprofit 501(c)(3) organizations. At its core, this is a commercial transaction through which the City intends to promote economic development and job opportunities in an underperforming neighborhood. Any "aid" flowing to Faith West as a result of the Transaction is indirect at best, and is incidental to the primary effects of economic development and community revitalization. The Transaction could not be perceived by any reasonably informed observer as an endorsement by the City of Faith West's religious philosophy. As a result, the Transaction does not run afoul of the Establishment Clause.*

## Basic Principles

1. The case law identifies three particular evils which the Establishment clause is intended to combat -- first, governmental subsidies which create entanglements or controls of religion by government; second, governmental endorsement of or indoctrination in specific religious views; and third, active government involvement in religious activity. As the United States Supreme Court has stated, there are “three main evils against which the Establishment Clause was intended to afford protection: sponsorship, financial support and active involvement of the sovereign in religious activity.” *Lemon v. Kurtzmann*, 403 U.S. 602 (1971) (quoting *Walz v. Tax Commissioner of City of New York*, 397 U.S. 664 (1970)).

2. Neutrality of purpose and effect are essential elements under the Establishment Clause case law. Direct support from taxpayer funds, for example, is more strictly scrutinized than other types of aid. By contrast, incidental benefits to religious entities from otherwise neutral programs are clearly permissible in most situations. See, e.g., *Agostini v. Felton*, 521 U.S. 203 (1997); *Zobrest v. Catalina Foothills School District*, 509 U.S. 1 (1993); and *Rosenberger v. University of Virginia*, 515 U.S. 819 (1995).

3. The courts have held on many occasions that incidental benefits to religious entities as a result of governmental actions are acceptable, if the governmental actions support primary public benefits, and if the actions are taken pursuant to programs which are neutral in both purpose and effect with respect to religion. The Court has held on numerous occasions that particular forms of even direct aid to religious entities may be permissible. For example:

- Subsidized bus transportation for parochial school students is constitutional (*Everson v. Bd. Of Educ.* 330 U.S. 1 (1947))
- Subsidized secular textbooks for parochial schools are constitutional (*Board of Education v. Allen*, 392 U.S. 236 (1968))
- Subsidies of evangelical student publications are constitutional (*Rosenberger*)
- Subsidies of remedial education programs conducted by public school teachers in parochial schools are constitutional (*Agostini*)
- Subsidies of the administrative cost of diagnostic testing for parochial school students are constitutional (*Wolman v. Walter*, 433 U.S. 229, 248 (1977))
- Subsidies of auxiliary services, materials, equipment, etc. in parochial schools are constitutional (*Mitchell v. Helms*, 530 U.S. 793 (2001))
- Subsidies of teen pregnancy prevention programs in religious hospitals are constitutional (*Bowen v. Kendrick*, 487 U.S. 589, 615-617 (1988))
- Subsidies of the administrative cost of standardized tests are constitutional (*Wolman*)

4. Under modern Establishment Clause jurisprudence, programs are not generally subject to challenge:

- Which serve valid secular purposes (such as economic development and/or job creation)

- Which are available to all manner of applicants, religious or otherwise, and which are therefore neutral on their face and neutral in their application with respect to religion
- Which do not apply the aid (if any) for religious activities
- Which do not define their beneficiaries on the basis of religion
- Which do not induce or coerce beneficiaries to choose for or against religion
- Which would not lead a reasonable informed observer to conclude that the government was endorsing religious beliefs or behavior

5. Several cases indicate clearly that neutral assistance for secular purposes to merely religiously affiliated institutions does not cause a constitutional problem.

In *Tilton v. Richardson*, 403 U.S. 672 (1971), the Court considered direct aid in the form of federal grants to construct new buildings for both secular and religious colleges. The Court found no Establishment Clause violation.

In *Roemer v. Bd. Of Public Works*, 426 U.S. 736 (1976), the Court approved grants of what were essentially operating funds to religiously affiliated institutions, under a neutral program involving both secular and religious colleges. A plurality of the Court declared that “religious institutions need not be quarantined from public benefits that are neutrally available to all”.

In *Zelman v. Smmons-Harris*, 536 U.S. 639 (2002), the Court considered a school voucher program in Cleveland. The Court effectively renounced the doctrine of “pervasively sectarian” (which had been mentioned in several earlier decisions), in the context of programs including “indirect aid” for religious beneficiaries. Likewise, in *Columbia Union College v. Oliver*, 254 F3rd 496 (2001), the Fourth Circuit held that even direct aid provided by Maryland’s Sellinger Grant Program, because of its neutrality and secular purposes and uses, did not require an analysis of pervasive sectarianism. Therefore, even a pervasively sectarian institution could participate in the government’s direct aid Sellinger program.

6. One final case should be mentioned: *American Atheists v. Detroit Downtown Development*, 567 F3d 278 (2009) After Detroit built its new football stadium, Ford Field, in the late 1990’s, the NFL agreed in 2002 to hold the 2006 Super Bowl at Ford Field. In 2003, Detroit instituted a development program to reimburse landowners in the neighborhood of Ford Field for up to 50% of the cost of exterior building refurbishments. \$11.5 million was so allocated. Approximately \$737,000 of City moneys went directly to three churches for repairs to the church buildings, including repairs to church signs and work on stained glass windows. The program was challenged because of the direct grants of public moneys to churches. The Sixth Circuit Court of Appeals rejected the challenge in its entirety.

“Everyone agrees that the program allocates benefits to a broad spectrum of entities on a neutral basis, as the City awards grants without regard to the religious, non-religious or areligious nature of the entity. The facial neutrality of the program, everyone also agrees, does not mask an intent to advance religion: Detroit sought to fix up its downtown, not to establish a religion. And as will generally be the case when a governmental program allocates generally available

benefits on a neutral basis and without a hidden agenda, this program does not have the impermissible effect of advancing religion in general or any one faith in particular. By endorsing all qualifying applicants, the program has endorsed none of them, and accordingly it has not run afoul of the federal or state religion clauses.” (Emphasis added)

Here, the Transaction is a commercial transaction undertaken by the parties for mutual consideration and benefit. The tax-exempt bonds are being made available under an entirely neutral program available to all 501(c)(3) borrowers (religious or otherwise); no direct governmental aid or subsidy is being provided; the program is designed to support economic development proposed by borrowers, and not their viewpoints (religious or otherwise); and there is no ongoing governmental involvement or entanglement in religious activity. The presence of “aid” of any kind, even indirect aid, is certainly not obvious. Further, the Borrower is taking additional proactive steps to ensure that bond proceeds will not be spent on any spaces where worship activities might arguably occur.

Given these facts, and the well-developed case law in this area, it clearly follows that there is no plausible basis for claiming an Establishment Clause violation. To the contrary, it is much more likely that failure to approve the Transaction under a facially neutral tax-exempt bond program, based solely on the fact that this particular Borrower happens to have a certain religious affiliation, might actually run afoul of the Free Exercise Clause of the First Amendment. If a neutral program with no direct governmental benefit is being made available across the board to all manner of potential 501(c)(3) borrowers, then it clearly becomes problematic under the Free Exercise Clause to exclude a particular 501(c)(3) based solely on its religious affiliation.