CHAPTER ONE

Charitable Giving Law: Basic Concepts

The purpose of this book is to summarize and analyze the law of charitable giving. For the most part, this law consists of federal tax law requirements, although state law can be implicated. The law of charitable giving frequently interrelates with the laws concerning tax-exempt status and public charity/private foundation classification of charitable organizations.

§ 1.1 INTRODUCTION TO CHARITABLE CONTRIBUTION DEDUCTION

The *charitable contribution* is the subject of extensive law. On the face of it, a charitable gift is a rather simple matter, requiring merely a *gift* and a *charitable* recipient. Though these elements are crucial (and are discussed throughout these pages), they by no means constitute the whole of the subject. Far more is involved in determining the availability and amount of the charitable contribution deduction.

There are, in fact, several charitable contribution deductions in American law, including three at the federal level: one for the income tax, one for the estate tax, and one for the gift tax. Most states have at least one form of charitable deduction, as do many counties and cities.

The principal charitable contribution deduction is the one that is part of the federal income tax system. A charitable contribution paid during a tax year generally is allowable as a deduction in computing taxable income for federal income tax purposes. This deduction is allowable irrespective of either the method of accounting employed or the date on which the contribution may have been pledged.

The federal income tax charitable contribution deduction is available to both individuals and corporations. In both instances, the amount deductible may depend on a variety of conditions and limitations. These elements of the law of charitable giving are the subject of much of this book. The federal gift and estate tax charitable contribution deductions are also discussed.

An income tax charitable deduction may be available for gifts of money and of property. This deduction can also be available with respect to outright transfers of money or property to charity, as well as to transfers of partial interests in property.[1] A gift of a partial interest in property is often known as *planned giving*.[2]

Aside from the law underlying the charitable deduction itself, several other aspects of law can bear on the availability of the deduction. These elements of law include receipt, recordkeeping, reporting, and disclosure requirements.[3] Also involved is the battery of laws regulating the fundraising process.[4]

There is much additional law that relates to charitable giving but is outside the scope of this book. This book is part of a series on nonprofit organizations; however, the series includes books on the law governing charitable organizations as such, the law comprising regulation of the charitable fundraising process, tax and financial planning for charitable organizations, the fundraising process itself, and the accounting rules for charitable organizations.[5]

Prior to review of the laws specifically applicable to charitable giving, it is necessary to understand the fundamentals of the body of federal tax law concerning tax exemption for charitable organizations and the history underlying this jurisprudence.

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[1]See Part Two.

[2]See Part Three.

[3]See Part Five.

[4]See, e.g., ch. 23.

[5]Companion books by the author provide a summary of the law concerning tax-exempt organizations as such (*Tax-Exempt Organizations*), planning considerations for tax-exempt organizations (*Planning Guide*), IRS examinations of tax-exempt organizations (*IRS Audits*), and regulation of the charitable fundraising process (*Fundraising*). Governance of tax-exempt organizations is the subject of Hopkins & Gross, *Nonprofit Governance: Law, Practices, & Trends* (Hoboken, NJ: John Wiley & Sons, 2009). These bodies of law are reviewed in less technical detail in Hopkins, *Starting and Managing a Nonprofit Organization: A Legal Guide*, 7th edition (Hoboken, NJ: John Wiley & Sons, 2017). All of these areas of the law (and others) are also covered in the *Bruce R. Hopkins' Nonprofit Law Library*, an e-book published by John Wiley & Sons in 2013.

§ 1.2 DEFINING *TAX-EXEMPT ORGANIZATIONS*

A tax-exempt organization is a unique entity. Almost always, it is a nonprofit organization.[6] The concept of a *nonprofit organization* is usually a matter of state law, while the concept of a *tax-exempt organization* is principally a matter of the federal tax law.

The nonprofit sector of U.S. society has never been totally comfortable with this name. Over the years, it has been called, among other titles, the *philanthropic sector*, *private sector*, *voluntary sector*, *third sector*, and *independent sector*. In a sense, none of these appellations is appropriate.[7]

The idea of sectors of U.S. society has bred the thought that, in the largest sense, there are three of them. The institutions of society within the United States are generally classified as governmental, for-profit, or nonprofit entities. These three sectors of society are seen as critical for a democratic state—or, as it is sometimes termed, a civil society. *Governmental entities* are the branches, departments, agencies, and bureaus of the federal, state, and local governments. *For-profit entities* constitute the business sector of this society. *Nonprofit organizations*, as noted, constitute what is frequently termed the third sector, the voluntary sector, the private sector, or the independent sector of U.S. society. These terms are sometimes confusing; for example, the term *private sector* has been applied to both the for-profit sector and the nonprofit sector.

The rules concerning the creation of nonprofit organizations are essentially a subject for state law. Although a few nonprofit organizations are chartered by the U.S. Congress, most are incorporated or otherwise formed under state law. There is a substantive difference between nonprofit and tax-exempt organizations. While almost all tax-exempt organizations are nonprofit organizations, there are types of nonprofit organizations that are not tax-exempt. There is considerable confusion as to what the term *nonprofit* means—but it certainly does not mean that the organization cannot earn a profit (excess of revenue over expenses). The essential difference between a nonprofit organization and a for-profit organization, from a law standpoint, is found in the *private inurement doctrine*.[8]

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[6]The term *nonprofit organization* is used throughout, rather than the term *not-for-profit*. The latter term is used, however, in the federal tax setting, to describe activities (rather than organizations) whose expenses do not qualify for the business expense deduction. Internal Revenue Code of 1986, as amended, section (IRC §) 183. Throughout this book, the Internal Revenue Code is cited as the "IRC." The IRC constitutes Title 26 of the United States Code.

[7]A discussion of these sectors appears in Ferris & Graddy, "Fading Distinctions among the Nonprofit, Government, and For-Profit Sectors," in Hodgkinson, Lyman, & Associates, *The Future of the Nonprofit Sector*, ch. 8 (San Francisco: Jossey-Bass, 1989). An argument that the sector should be called the first sector is advanced in Young, "Beyond Tax Exemption: A Focus on Organizational Performance versus Legal Status," in *id*. ch. 11.

[8]See *Tax-Exempt Organizations* ch. 12.

The concept of a nonprofit organization is best understood through a comparison with a for-profit organization. In many respects, the characteristics of the two categories of organizations are identical: both require a legal form, have a board of directors and officers, pay compensation, face essentially the same expenses, make investments, produce goods and/or services, and are able to receive a profit.

A for-profit entity, however, has owners: those who hold the equity in the enterprise, such as stockholders of a corporation. The for-profit organization is operated for the benefit of its owners; the profits of the enterprise are passed through to them, such as the payment of dividends on shares of stock. This is what is meant by the term *for-profit organization*; it is one that is intended to generate a profit for its owners. The transfer of the profits from the organization to its owners is considered the inurement of net earnings to the owners in their private capacity.

Unlike the for-profit entity, the nonprofit organization generally is not permitted to distribute its profits (net earnings) to those who control and/or financially support it; a nonprofit organization usually does not have any owners (equity holders).[9] Consequently, the private inurement doctrine is the substantive dividing line that differentiates, for law purposes, nonprofit organizations and for-profit organizations.

Thus, both nonprofit organizations and for-profit organizations are able to generate a profit. The distinction between the two entities pivots on what is done with this profit.[10] The for-profit organization endeavors to produce a profit for what one commentator called its "residual claimants."[11] The nonprofit organization usually seeks to make that profit work for some end that is beneficial to society.

The private inurement doctrine is applicable to many types of tax-exempt organizations. It is, however, most pronounced with respect to charitable organizations.[12] By contrast, in some types of nonprofit (and tax-exempt) organizations, the provision of forms of private benefit is the exempt purpose

[9]The Supreme Court wrote that a "nonprofit entity is ordinarily understood to differ from a for-profit corporation principally because it 'is barred from distributing its net earnings, if any, to individuals who exercise control over it, such as members, officers, directors, or trustees'" (Camps Newfound/Owatonna, Inc. v. Town of Harrison, 520 U.S. 564, 585 (1997), quoting from Hansmann, "The Role of Nonprofit Enterprise," 89 *Yale L.J.* 835, 838 (1980)).

[10]One commentator stated that charitable and other nonprofit organizations "are not restricted in the amount of profit they may make; restrictions apply only to what they may do with the profits." Weisbrod, "The Complexities of Income Generation for Nonprofits," in Hodgkinson et al., ch. 7.

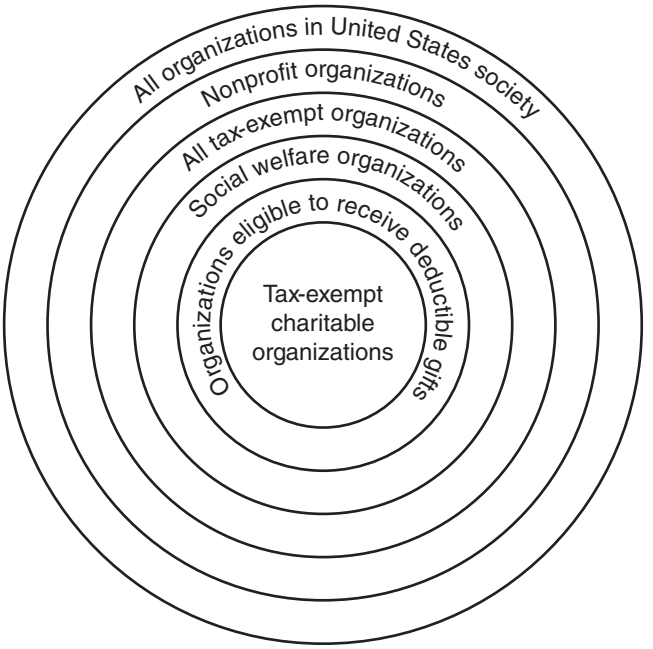
[11]Norwitz, "The Metaphysics of Time: A Radical Corporate Vision," 46 *Bus. Law*. (no. 2) 377 (Feb. 1991).

[12]The federal law of tax exemption for charitable organizations requires that each of these entities be organized and operated so that "no part of . . . [its] net earnings . . . inures to the benefit of any private shareholder or individual." IRC § 501(c)(3).

and function. This is the case, for example, with employee benefit trusts, social clubs, and, to an extent, political committees.[13]

As this chapter has indicated thus far, there are subsets and sub-subsets within the nonprofit sector. Tax-exempt organizations are subsets of nonprofit organizations. Charitable organizations (using the broad definition of that term[14]) are subsets of tax-exempt organizations. Charitable organizations in the narrow sense are subsets of charitable organizations in the broader sense of that term.[15]

These elements of the nonprofit sector may be visualized as a series of concentric circles, as shown below.



[13]IRC §§ 501(c)(9), (17), and (21) (employee benefit trusts), and IRC § 501(c)(7) (social clubs). See *Tax-Exempt Organizations* chs. 18, 15, respectively.

[14]This broad definition carries with it the connotation of philanthropy. E.g., Van Til, "Defining Philanthropy," in Van Til & Associates, *Critical Issues in American Philanthropy*, ch. 2 (San Francisco: Jossey-Bass, 1990). Also Payton, *Philanthropy: Voluntary Action for the Public Good* (New York: Macmillan, 1988); O'Connell, *Philanthropy in Action* (New York: The Foundation Center, 1987).

[15]The complexity of the federal tax law is such that the charitable sector (using the term in its broadest sense) is also divided into two segments: charitable organizations that are considered private (private foundations) and charitable organizations that are considered public (all charitable organizations other than those that are considered private); these nonprivate charities are frequently referred to as public charities. See *Tax-Exempt Organizations* ch. 12.

For a variety of reasons, the organizations constituting the nation's independent sector have been granted exemption from federal and state taxation; in some instances, they have been accorded the status of entities contributions to which are tax-deductible under federal and state tax law. Federal, state, and usually local law provide exemptions from income tax for (and, where appropriate, deductibility of contributions to) a wide variety of organizations, including churches, colleges, universities, health care providers, various charities, civic leagues, labor unions, trade associations, social clubs, political organizations, veterans' groups, fraternal organizations, and certain cooperatives. Yet, despite the longevity of most of these exemptions, the underlying rationale for them is vague and varying. Nonetheless, the rationales for exemption appear to be long-standing public policy, inherent tax theory, and unique and specific reasons giving rise to a particular tax provision.

§ 1.3 CHARITABLE ORGANIZATIONS LAW PHILOSOPHY

The definition in the law of the term *nonprofit organization* and the concept of the nonprofit sector as critical to the creation and functioning of a civil society do not distinguish nonprofit organizations that are tax-exempt from those that are not. This is because the tax aspect of nonprofit organizations is not relevant to either subject. Indeed, rather than defining either the term *nonprofit organization* or its societal role, the federal tax law principles respecting tax exemption of these entities reflect and flow out of the essence of these subjects.

This is somewhat unusual; most tax laws are based on some form of rationale that is inherent in tax policy. The law of charitable and other tax-exempt organizations, however, has very little to do with any underlying tax policy. Rather, this aspect of the tax law is grounded in a body of thought quite distant from tax policy: political philosophy as to the proper construct of a democratic society.

This raises, then, the matter of the rationale for tax-exemption eligibility of nonprofit organizations. That is, what is the fundamental characteristic—or characteristics—that enables a nonprofit organization to qualify as a tax-exempt organization? In fact, there is no single qualifying feature. This circumstance mirrors the fact that the present-day statutory tax exemption rules are not the product of a carefully formulated plan. Rather, they are a hodgepodge of federal statutory law that has evolved over nearly 100 years, as various Congresses have deleted from (infrequently) and added to (frequently) the roster of exempt entities, causing it to grow substantially over the decades. As one observer wrote, the various categories of tax-exempt organizations "are not the result of any planned legislative scheme" but

were enacted over the decades "by a variety of legislators for a variety of reasons."[16]

There are six basic rationales underlying qualification for tax-exempt status for nonprofit organizations. On a simplistic plane, a nonprofit entity is tax-exempt because Congress wrote a provision in the Internal Revenue Code according tax exemption to it. Thus, some organizations are tax-exempt for no more engaging reason than that Congress said so. Certainly, as to this type of exemption, there is no grand philosophical principle buttressing the exemption.

Some of the federal income tax exemptions were enacted in the spirit of being merely declaratory of, or furthering, then-existing law. The House Committee on Ways and Means, in legislating a forerunner to the provision that exempts certain voluntary employees' beneficiary associations, commented that "these associations are common today [1928] and it appears desirable to provide specifically for their exemption from ordinary corporation tax."[17] The exemption for nonprofit cemetery companies was enacted to parallel then-existing state and local property tax exemptions.[18] The exemption for farmers' cooperatives has been characterized as part of the federal government's posture of supporting agriculture.[19] The provision exempting certain U.S. corporate instrumentalities from tax was deemed declaratory of the exemption simultaneously provided by the particular enabling statute.[20] The provision according tax exemption to multiparent title-holding corporations was derived from the refusal of the Internal Revenue Service (IRS) to recognize exempt status for title-holding corporations serving more than one unrelated parent entity.

Tax exemption for categories of nonprofit organizations can arise as a by-product of enactment of other legislation. In these instances, tax exemption is granted to facilitate accomplishment of the purpose of another legislative end. Thus, tax-exempt status has been approved for funds underlying employee benefit programs. Other examples include tax exemption for professional football leagues that emanated out of the merger of the National Football League and the American Football League, and for state-sponsored providers of health care to the needy, which was required to accommodate the goals of Congress in creating health care delivery legislation.

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[16]McGovern, "The Exemption Provisions of Subchapter F," 29 *Tax Law*. 523 (1976). Other overviews of the various tax exemption provisions are in Hansmann, "The Rationale for Exempting Nonprofit Organizations from Corporate Income Taxation," 91 *Yale L.J.* 69 (1981); Bittker & Rahdert, "The Exemption of Nonprofit Organizations from Federal Income Taxation," 85 *Yale L.J.* 299 (1976).

[17]H. Rep. No. 72, 78th Cong., 1st Sess. 17 (1928).

[18]Lapin, "The Golden Hills and Meadows of the Tax-Exempt Cemetery," 44 *Taxes* 744 (1966).

[19]"Comment," 27 *Iowa L. Rev*. 128, 151–155 (1941).

[20]H. Rep. No. 704, 73d Cong., 2d Sess. 21–25 (1934).

There is a pure tax rationale for some tax-exempt organizations. Social clubs stand out as an illustration of this category.

The fourth rationale for tax-exempt status is a policy one—not tax policy, but policy with regard to less essential elements of the structure of a civil society. This is why, for example, tax-exempt status has been granted to entities as diverse as fraternal organizations, title-holding companies, farmers' cooperatives, certain insurance companies, and prepaid tuition plans.

The fifth rationale for tax-exempt status rests solidly on a philosophical principle. Yet, there are degrees of scale here; some principles are less majestic than others. Thus, there are nonprofit organizations that are tax-exempt because their objectives are of direct importance to a significant segment of society and indirectly of consequence to all of society. Within this frame lies the rationale for tax exemption for entities such as labor organizations, trade and business associations, and veterans' organizations.

The sixth rationale for tax-exempt status for nonprofit organizations is predicated on the view that exemption is required to facilitate achievement of an end of significance to the entirety of society. Most organizations that are generally thought of as *charitable* in nature[21] are entities that are meaningful to the structure and functioning of society in the United States. At least to some degree, this rationale embraces social welfare organizations. This rationale may be termed the *public policy* rationale.[22]

(a) Public Policy and National Heritage

The public policy rationale is one involving political philosophy rather than tax policy. The key concept underlying this philosophy is *pluralism*—more accurately, the pluralism of institutions, which is a function of competition between various institutions within the three sectors of society. In this context, the competition is between the nonprofit and governmental sectors. This element is particularly critical in the United States, whose history originates in distrust of government. (When the issue is unrelated business income taxation, the matter is one of competition between the nonprofit and for-profit sectors.) Here, the nonprofit sector serves as an alternative to the governmental sector as a means of addressing society's problems.

One of the greatest exponents of pluralism was John Stuart Mill. He wrote in *On Liberty*, published in 1859:

> In many cases, though individuals may not do the particular thing so well, on the average, as officers of government, it is nevertheless desirable that it should

[21] These are the charitable, educational, religious, scientific, and like organizations referenced in IRC § 501(c)(3).

[22] See *Tax-Exempt Organizations* § 1.3.

> be done by them, rather than by the government, as a means to their own mental education—a mode of strengthening their active faculties, exercising their judgment, and giving them a familiar knowledge of the subjects with which they are thus left to deal. This is a principal, though not the sole, recommendation of . . . the conduct of industrial and philanthropic enterprises by voluntary associations.

Following a discussion of the importance of "individuality of development, and diversity of modes of action," Mill wrote:

> Government operations tend to be everywhere alike. With individuals and voluntary associations, on the contrary, there are varied experiments, and endless diversity of experience. What the State can usefully do is to make itself a central depository, and active circulator and diffuser, of the experience resulting from many trials. Its business is to enable each experimentalist to benefit by the experiments of others; instead of tolerating no experiments but its own.

This conflict among the sectors—a sorting out of the appropriate role of governments and nonprofit organizations—is, in a healthy society, a never-ending process, ebbing and flowing with the politics of the day. A Congress may work to reduce the scope of the federal government and a president may proclaim that the "era of big government is over," while a preceding and/or succeeding generation may celebrate strong central government.

One of the greatest commentators on the impulse and tendency in the United States to utilize nonprofit organizations was Alexis de Tocqueville. Writing in 1835, in *Democracy in America*, he observed:

> Feelings and opinions are recruited, the heart is enlarged, and the human mind is developed only by the reciprocal influence of men upon one another. I have shown that these influences are almost null in democratic countries; they must therefore be artificially created, and this can only be accomplished by associations.

De Tocqueville's classic formulation on this subject came in his portrayal of Americans' use of "public associations" as a critical element of the societal structure:

> Americans of all ages, all conditions, and all dispositions constantly form associations. They have not only commercial and manufacturing companies, in which all take part, but associations of a thousand other kinds, religious, moral, serious, futile, general or restricted, enormous or diminutive. The Americans make associations to give entertainments, to found seminaries, to build inns, to construct churches, to diffuse books, to send missionaries to the antipodes; in this manner they found hospitals, prisons, and schools. If it is proposed to inculcate some truth or to foster some feeling by the encouragement of a great example, they form a society. Wherever at the head of some new undertaking you see the government in France, or a man of rank in England, in the United States you will be sure to find an association.

This was the political philosophical climate concerning nonprofit organizations in place when Congress, toward the close of the nineteenth century, began considering enactment of an income tax. Although courts would subsequently articulate policy rationales for tax exemption, one of the failures of American jurisprudence is that the Supreme Court and the lower courts have never adequately articulated the public policy doctrine.

Contemporary Congresses legislate by writing far more intricate statutes than their forebears, and in doing so usually leave in their wake rich deposits in the form of extensive legislative histories. Thus, it is far easier to ascertain what a recent Congress meant when creating a law than is the case with respect to an enactment ushered in decades ago.

At the time a constitutional income tax was coming into existence (enacted in 1913[23]), Congress legislated in spare language and rarely embellished upon its statutory handiwork with legislative histories. Therefore, there is no contemporary record, in the form of legislative history, of what members of Congress had in mind when they first started creating categories of charitable and other tax-exempt organizations. Congress, it is generally assumed, saw itself doing what other legislative bodies have done over the centuries. One observer stated that the "history of mankind reflects that our early legislators were not setting precedent by exempting religious or charitable organizations" from income tax.[24] That is, the political philosophical policy considerations pertaining to nonprofit organizations were such that taxation of these entities—considering their contributions to the well-being and functioning of society—was unthinkable.

Thus, in the process of writing the Revenue Act of 1913, Congress viewed tax exemption for charitable organizations as the only way to consistently correlate tax policy to political theory on the point, and saw the exemption of charities in the federal tax statutes as an extension of comparable practice throughout the whole of history. No legislative history enlarges upon the point. Presumably, Congress simply believed that these organizations ought not to be taxed and found the proposition sufficiently obvious that extensive explanation of its actions was not required.

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[23]In 1894, Congress imposed a tax on corporate income. This was the first time Congress was required to define the appropriate subjects of tax exemption (inasmuch as prior tax schemes specified the entities subject to taxation). The Tariff Act of 1894 provided exemption for nonprofit charitable, religious, and educational organizations; fraternal beneficiary societies; certain mutual savings banks; and certain mutual insurance companies. The 1894 legislation succumbed to a constitutional law challenge (Pollock v. Farmers' Loan & Trust Co., 157 U.S. 429 (1895), *overruled on other grounds sub nom*. South Carolina v. Baker, 485 U.S. 505 (1988)). The Sixteenth Amendment was subsequently ratified, and the Revenue Act of 1913 was enacted. In general, Pollack, "Origins of the Modern Income Tax, 1894–1913," 66 *Tax Law*. (no. 2) (Winter 2013).

[24]McGovern, "The Exemption Provisions of Subchapter F," 29 *Tax Law*. 523, 524 (1976).

Some clues are found in the definition of *charitable activities* in the income tax regulations,[25] which are thought to reflect congressional intent. The regulations refer to purposes such as relief of the poor, advancement of education and science, erection and maintenance of public buildings, and lessening of the burdens of government. These definitions of charitable undertakings clearly derive from the Preamble to the Statute of Charitable Uses,[26] written in England in 1601. Reference is there made to certain "charitable" purposes:

> some for relief of aged, impotent and poor people, some for maintenance of sick and maimed soldiers and mariners, schools of learning, free schools, and scholars in universities, some for repair of bridges, ports, havens, cause-ways, churches, sea-banks and highways, some for education and preferment of orphans, some for or towards relief, stock or maintenance for houses of correction, some for marriages of poor maids, some for supportation, aid and help of young tradesmen, handicraftsmen and persons decayed, and others for relief of redemption of prisoners or captives. . . .

As this indicates, a subset of the public policy doctrine implies that tax exemption for charitable organizations derives from the concept that they perform functions that, in the absence of these organizations, government would have to perform. This view leads to the conclusion that government is willing to forgo the tax revenues it would otherwise receive in return for the public interest services rendered by charitable organizations.

Since the founding of the United States and beforehand in the Colonial period, tax exemption—particularly with respect to religious organizations—was common.[27] Churches were uniformly spared taxation.[28] This practice has been sustained throughout the history of the nation—not only at the federal level, but also at the state and local levels of government, which grant property tax exemptions, as an example.

The Supreme Court concluded, soon after enactment of the income tax, that the foregoing rationalization was the basis for the federal tax exemption for charitable entities (although in doing so it reflected a degree of uncertainty in the strength of its reasoning, undoubtedly based on the paucity of legislative history). In 1924, the Court stated that "[e]vidently the exemption is made in recognition of the benefit which the public derives from corporate activities of the class named, and is intended to aid them when [they are] not conducted for private gain."[29] Nearly 50 years later, in upholding the constitutionality

[25]Income Tax Regulations (Reg.) § 1.501(c)(3)-1(d)(2).

[26]Statute of Charitable Uses, 43 Eliz., c.4.

[27]Cobb, *The Rise of Religious Liberty in America*, 482–528 (1902).

[28]Torpey, *Judicial Doctrines of Religious Rights in America*, 171 (1948).

[29]Trinidad v. Sagrada Orden de Predicadores de la Provincia del Santisimo Rosario de Filipinas, 263 U.S. 578, 581 (1924).

of income tax exemption for religious organizations, the Court observed that the "State has an affirmative policy that considers these groups as beneficial and stabilizing influences in community life and finds this classification [tax exemption] useful, desirable, and in the public interest."[30] Subsequently, the Court wrote that, for most categories of nonprofit organizations, "exemption from federal income tax is intended to encourage the provision of services that are deemed socially beneficial."[31]

A few other courts have taken up this theme. One federal court of appeals wrote that the "reason underlying the exemption granted" to charitable organizations is that "the exempted taxpayer performs a public service."[32] This court continued:

> The common element of charitable purposes within the meaning of the . . . [federal tax law] is the relief of the public of a burden which otherwise belongs to it. Charitable purposes are those which benefit the community by relieving it pro tanto from an obligation which it owes to the objects of the charity as members of the community.[33]

This federal appellate court subsequently observed, as respects the exemption for charitable organizations, that "[o]ne stated reason for a deduction or exemption of this kind is that the favored entity performs a public service and benefits the public or relieves it of a burden which otherwise belongs to it."[34] Another federal court opined that the justification of the charitable contribution deduction was "historically . . . that by doing so, the Government relieves itself of the burden of meeting public needs which in the absence of charitable activity would fall on the shoulders of the Government."[35]

Only one federal court has fully articulated the public policy doctrine, even there noting that the "very purpose" of the charitable contribution deduction "is rooted in helping institutions because they serve the public good."[36] The doctrine was explained as follows:

> [A]s to private philanthropy, the promotion of a healthy pluralism is often viewed as a prime social benefit of general significance. In other words, society can be seen as benefiting not only from the application of private wealth to specific

[30] Walz v. Tax Commission, 397 U.S. 664, 673 (1970).
[31] Portland Golf Club v. Commissioner, 497 U.S. 154, 161 (1990).
[32] Duffy v. Birmingham, 190 F.2d 738, 740 (8th Cir. 1951).
[33] *Id*.
[34] St. Louis Union Trust Co. v. United States, 374 F.2d 427, 432 (8th Cir. 1967).
[35] McGlotten v. Connally, 338 F. Supp. 448, 456 (D.D.C. 1972).
[36] Green v. Connally, 330 F. Supp. 1150, 1162 (D.D.C. 1971), *aff'd sub nom*. Coit v. Green, 404 U.S. 997 (1971).

> purposes in the public interest but also from the variety of choices made by individual philanthropists as to which activities to subsidize. This decentralized choice-making is arguably more efficient and responsive to public needs than the cumbersome and less flexible allocation process of government administration.[37]

Occasionally, Congress issues a pronouncement on this subject. One of these rare instances occurred in 1939, when the report of the House Committee on Ways and Means, part of the legislative history of the Revenue Act of 1938, stated:

> The exemption from taxation of money or property devoted to charitable and other purposes is based upon the theory that the government is compensated for the loss of revenue by its relief from financial burden which would otherwise have to be met by appropriations from public funds, and by the benefits resulting from the promotion of the general welfare.[38]

The doctrine also is referenced from time to time in testimony before a congressional committee. For example, the Secretary of the Treasury testified before the House Committee on Ways and Means in 1973 regarding organizations that he termed "voluntary charities, which depend heavily on gifts and bequests," observing:

> These organizations are an important influence for diversity and a bulwark against over-reliance on big government. The tax privileges extended to these institutions were purged of abuse in 1969 and we believe the existing deductions for charitable gifts and bequests are an appropriate way to encourage those institutions. We believe the public accepts them as fair.[39]

The literature on this subject is extensive. The contemporary versions of it are traceable to 1975, when the public policy rationale was reexamined and reaffirmed by the Commission on Private Philanthropy and Public Needs (informally known as the Filer Commission). The Commission observed:

> Few aspects of American society are more characteristically, more famously American than the nation's array of voluntary organizations, and the support in both time

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[37]7 *Id*., 330 F. Supp. at 1162. In a situation where a partnership intended to make $4.75 million in charitable contributions but the gifts were, due to a clerical error, made by means of a business corporation's checks and the matter was corrected, a court refused to uphold the IRS's disallowance of the deduction, declaring that "[t]o disallow a charitable deduction simply because of a clerical error goes against the liberal policy of encouraging charitable giving" (Green v. United States, 2016 WL 552964 (W.D. Okla. 2016)). Likewise, Green v. United States, 2015 WL 1482508 (W.D. Okla. 2015), *rev'd on other ground*, 880 F.3d 519 (10th Cir. 2017).

[38]H. Rep. No. 1860, 75th Cong., 3d Sess. 19 (1939).

[39]Department of the Treasury, Proposals for Tax Change, Apr. 30, 1973.

> and money that is given to them by its citizens. Our country has been decisively different in this regard, historian Daniel Boorstin observes, "from the beginning." As the country was settled, "communities existed before governments were there to care for public needs." The result, Boorstin says, was that "voluntary collaborative activities" were set up to provide basic social services. Government followed later.
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> The practice of attending to community needs outside of government has profoundly shaped American society and its institutional framework. While in most other countries, major social institutions such as universities, hospitals, schools, libraries, museums and social welfare agencies are state-run and state-funded, in the United States many of the same organizations are privately controlled and voluntarily supported. The institutional landscape of America is, in fact, teeming with nongovernmental, noncommercial organizations, all the way from some of the world's leading educational and cultural institutions to local garden clubs, from politically powerful national associations to block associations—literally millions of groups in all. This vast and varied array is, and has long been widely recognized as, part of the very fabric of American life. It reflects a national belief in the philosophy of pluralism and in the profound importance to society of individual initiative.
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> Underpinning the virtual omnipresence of voluntary organizations, and a form of individual initiative in its own right, is the practice—in the case of many Americans, the deeply ingrained habit—of philanthropy, of private giving, which provides the resource base for voluntary organizations.
>
> These two interrelated elements, then, are sizable forces in American society, far larger than in any other country. And they have contributed immeasurably to this country's social and scientific progress. On the ledger of recent contributions are such diverse advances as the creation of noncommercial "public" television, the development of environmental, consumerist and demographic consciousness, community-oriented museum programs, the protecting of land and landmarks from the often heedless rush of "progress." The list is endless and still growing; both the number and deeds of voluntary organizations are increasing. "Americans are forever forming associations," wrote de Tocqueville. They still are: tens of thousands of environmental organizations have sprung up in the last few years alone. Private giving is growing, too, at least in current dollar amounts.[40]

Here, the concept of *philanthropy* enters, with the view that charitable organizations, maintained by tax exemption and nurtured by an ongoing flow of deductible contributions, reflect the American philosophy that not all policy making and problem solving should be reposed in the governmental sector. Earlier, a jurist wrote, in a frequently cited article, that philanthropy

> is the very possibility of doing something different than government can do, of creating an institution free to make choices government cannot—even seemingly

[40] *Report of the Commission on Private Philanthropy and Public Needs: Giving in America—Toward a Stronger Voluntary Sector* at 9–10 (1975).

> arbitrary ones—without having to provide a justification that will be examined in a court of law, which stimulates much private giving and interest.[41]

A component part of the public policy doctrine is its emphasis on *voluntarism*. This principle was expressed as follows:

> Voluntarism has been responsible for the creation and maintenance of churches, schools, colleges, universities, laboratories, hospitals, libraries, museums, and the performing arts; voluntarism has given rise to the public and private health and welfare systems and many other functions and services that are now an integral part of the American civilization. In no other country has private philanthropy become so vital a part of the national culture or so effective an instrument in prodding government to closer attention to social needs.[42]

One of the modern-day advocates of the role and value of the independent sector in the United States was John W. Gardner, former Secretary of Health, Education, and Welfare, founder of Common Cause, and one of the founders of Independent Sector. Mr. Gardner wrote extensively on the subject of the necessity for and significance of the nation's nonprofit sector. He stated that the "area of our national life encompassed by the deduction for religious, scientific, educational, and charitable organizations lies at the very heart of our intellectual and spiritual striving as a people, at the very heart of our feeling about one another and about our joint life."[43] He added that the "private pursuit of public purpose is an honored tradition in American life"[44] and believed that "[a]ll elements in the private sector should unite to maintain a tax policy that preserves our pluralism."[45] Likewise, Robert J. Henle, formerly president of Georgetown University, wrote of how the "not-for-profit, private sector promotes the free initiative of citizens and gives them an opportunity on a nonpolitical basis to join together to promote the welfare of their fellow citizens or the public purpose to which they are attracted."[46]

It is not possible, in a book of this nature, to fully capture the philosophical underpinnings of the nonprofit sector. This task has been accomplished, however, by Brian O'Connell while president of Independent Sector.[47] In a foreword to Mr. O'Connell's work, John W. Gardner stated this basic truth:

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[41]Friendly, "The Dartmouth College Case and the Public-Private Penumbra," 12 *Tex. Q.* (2d Supp.) 141, 171 (1969). Two other prominent sources are Rabin, "Charitable Trusts and Charitable Deductions," 41 *N.Y.U. L. Rev.* 912 (1966); Saks, "The Role of Philanthropy: An Institutional View," 46 *Va. L. Rev.* 516 (1960).

[42]Fink, "Taxation and Philanthropy—A 1976 Perspective," 3 *J. Coll. & Univ. L.* 1, 6–7 (1975).

[43]Gardner, "Bureaucracy vs. The Private Sector," 212 *Current* 17–18 (May 1979).

[44]*Id.* at 17.

[45]*Id.* at 18.

[46]Henle, "The Survival of Not-for-Profit, Private Institutions," *America*, Oct. 23, 1976, at 252.

[47]O'Connell, *America's Voluntary Spirit* (New York: The Foundation Center, 1983).

"All Americans interact with voluntary or nonprofit agencies and activities regularly, although they are often unaware of this fact."[48] Still, the educational process must continue, for, as Mr. Gardner wrote, "The sector enhances our creativity, enlivens our communities, nurtures individual responsibility, stirs life at the grassroots, and reminds us that we were born free."[49] Mr. O'Connell's collection includes thoughts from sources as diverse as Max Lerner ("the associative impulse is strong in American life; no other civilization can show as many secret fraternal orders, businessmen's 'service clubs,' trade and occupational associations, social clubs, garden clubs, women's clubs, church clubs, theater groups, political and reform associations, veterans' groups, ethnic societies, and other clusterings of trivial or substantial importance"[50]); Daniel J. Boorstin ("in America, even in modern times, communities existed before governments were there to care for public needs"[51]); Merle Curti ("voluntary association with others in common causes has been thought to be strikingly characteristic of American life"[52]); John W. Gardner ("For many countries . . . monolithic central support of all educational, scientific, and charitable activities would be regarded as normal . . . [b]ut for the United States it would mean the end of a great tradition"[53]); Richard C. Cornuelle ("We have been unique because another sector, clearly distinct from the other two, has, in the past, borne a heavy load of public responsibility"[54]); John D. Rockefeller III ("The third sector is . . . the seedbed for organized efforts to deal with social problems"[55]); Waldemar A. Neilsen ("the ultimate contribution of the Third Sector to our national life—namely what it does to ensure the continuing responsiveness, creativity and self-renewal of our democratic society"[56]); Richard W. Lyman ("an array of its [the independent sector's] virtues that is by now fairly familiar: its contributions to pluralism and diversity, its tendency to enable individuals to participate in civic life in ways that make sense to them and help to combat that corrosive feeling of powerlessness that is among the dread social diseases of our era, its encouragement of innovation and its capacity to act as a check on the inadequacies of government"[57]); and himself ("The problems of contemporary society are more complex, the solutions more involved and the satisfactions more

[48] *Id*. at xi.
[49] *Id*. at xv.
[50] *Id*. at 81.
[51] *Id*. at 131.
[52] *Id*. at 162.
[53] *Id*. at 256.
[54] *Id*. at 278.
[55] *Id*. at 356.
[56] *Id*. at 368.
[57] *Id*. at 371.

obscure, but the basic ingredients are still the caring and the resolve to make things better").[58]

Consequently, it is erroneous to regard the charitable contribution deduction and tax exemption as anything other than a reflection of this larger doctrine. Congress is not merely "giving" eligible nonprofit organizations any "benefits"; the charitable deduction or exemption from taxation is not a "loophole," a "preference," or a "subsidy"—it is not really an "indirect appropriation."[59] Rather, the various Internal Revenue Code provisions that establish the tax exemption system exist as a reflection of the affirmative policy of American government to refrain from inhibiting by taxation the beneficial activities of qualified tax-exempt organizations acting in community and other public interests.[60]

(b) Other Rationales

There are, as noted, other rationales for tax exemption that pertain to charitable organizations. One of these, somewhat less lofty than that accorded charitable and social welfare organizations, is extended as justification for the exemption of trade associations and other forms of business leagues.[61] These entities function to promote the welfare of a segment of society: the business, industrial, and professional community. An element of the philosophy supporting this type of tax exemption is that a healthy business climate advances the public welfare. The tax exemption for labor unions and other labor organizations rests upon a similar rationale.[62]

The tax exemption for fraternal beneficiary organizations also depends, at least in part, on this defense. A study of the insurance practices of large

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[58] *Id*. at 408.

[59] The congressional budget and tax committees and the Department of the Treasury measure the economic value (revenue "losses") of various tax preferences, such as tax deductions, credits, and exclusions (termed tax expenditures). The federal income tax charitable contribution deduction tends to be the sixth- or seventh-largest tax expenditure.

[60] In general, Pappas, "The Independent Sector and the Tax Law: Defining Charity in an Ideal Democracy," 64 *S. Cal. L. Rev*. 461 (Jan. 1991).

There is another rationale for tax exemption, known as the *inherent tax rationale*. See *Tax-Exempt Organizations* § 1.5. The essence of this rationale is that the receipt of what otherwise might be deemed income by a tax-exempt organization is not a taxable event, in that the organization is merely a convenience or means to an end, a vehicle whereby those participating in the enterprise may receive and expend money collectively in much the same way as they would if the money were expended by them individually. Although this rationale is not followed in the charitable organizations setting, it chiefly underlies the tax exemption for organizations such as social clubs, homeowners' associations, and political organizations.

[61] See *Tax-Exempt Organizations* ch. 14.

[62] *Id*. § 16.1.

societies by the Department of the Treasury[63] concluded that this rationale is inapplicable with respect to the insurance programs of these entities because the "provision of life insurance and other benefits is generally not considered a good or service with significant external benefits" to society. The report stated, however, that "tax exemption for these goods and services [insurance and like benefits] may be justified in order to encourage" the charitable activities conducted by these organizations. The inherent tax rationale[64] "may" provide a basis for tax exemption for "certain" of these societies' services, according to the report. Further, the report observed that "[i]nsurance is not a type of product for which consumers may lack access to information on the appropriate quantity or quality that they need." Therefore, the market failure rationale[65] "may not be applicable" in this instance.

Other federal tax exemption provisions may be traced to an effort to achieve a particular objective. These provisions tend to be of more recent vintage, testimony to the fact of a more complex Internal Revenue Code. For example, specific tax exemption for veterans' organizations[66] was enacted to create a category of organizations entitled to use a particular exemption from the unrelated business income tax,[67] and statutory exemption for homeowners' associations[68] came about because of a shift in the policy of the Internal Revenue Service (IRS) regarding the scope of tax exemption provided for social welfare organizations. The tax exemption for college and university investment vehicles was the result of Congress's effort to preserve the exempt status of a specific common investment fund in the face of an IRS determination to the contrary.[69] As is so often the case with respect to the tax law generally, a particular tax exemption provision can arise as the result of case law, or to clarify it; this was the origin of statutes granting tax exemption to cooperative hospital service organizations,[70] charitable risk pools,[71] child care organizations,[72] public safety testing entities,[73] and qualified tuition programs.[74]

All of the foregoing rationales for tax-exempt organizations have been described in philosophical, historical, political, policy, or technical tax terms.

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[63]U.S. Department of the Treasury, *Report to the Congress on Fraternal Benefit Societies*, Jan. 15, 1993.

[64]See *supra* note 60.

[65]See text accompanied by *infra* notes 76–79.

[66]See *Tax-Exempt Organizations* § 19.11(a).

[67]*Id*. § 24.10, text accompanied by note 947.

[68]*Id*. § 19.14.

[69]*Id*. § 11.5.

[70]*Id*. § 11.4.

[71]*Id*. § 11.6.

[72]*Id*. § 8.8.

[73]*Id*. § 11.3.

[74]*Id*. § 19.17.

Yet another approach to an understanding of exempt organizations can be found in economic theory.

Principles of economics are founded on the laws of supply (production) and demand (consumption). Using the foregoing analyses, exempt organizations appear to have arisen in response to the pressures of the supply side—namely, the need for the goods and services provided—and the force of pluralistic institutions and organizations in society. Others, however, view tax-exempt organizations as responses to sets of social needs that can be described in demand-side economic terms, a "positive theory of consumer demand."[75]

According to the demand-side analysis, consumers in many contexts prefer to deal with nonprofit, tax-exempt, usually charitable organizations in purchasing goods and services, because the consumer knows that a nonprofit organization has a "legal commitment to devote its entire earnings to the production of services,"[76] whereas for-profit organizations have a great incentive to raise prices and cut quality. Generally, it is too difficult for consumers to monitor these forces. This means that consumers have a greater basis for trusting tax-exempt organizations to provide the services—a restatement, in a way, of the fiduciary concept. Thus, the consumer, pursuant to this analysis, "needs an organization that he can trust, and the non-profit, because of the legal constraints under which it must operate, is likely to serve that function better than its for-profit counterpart."[77]

This phenomenon has been described as "market failure" as far as for-profit organizations are concerned, in that, in certain circumstances, the market is unable to police the producers by means of ordinary contractual devices.[78] This, in turn, has been described as "contract failure," which occurs when consumers "may be incapable of accurately evaluating the goods promised or delivered" and "market competition may well provide insufficient discipline for a profit-seeking producer."[79] Hence, according to this theory, the consuming public selects the nonprofit organization, which operates without the profit motive and offers the consumer the "trust element" that the for-profit organizations cannot always provide.

Although the economic demand-side theory is fascinating and undoubtedly contains much truth, it probably overstates the aspect of consumer demand and downplays historical realities, tax considerations, and human frailties. The nonprofit organization antedates the for-profit corporation, and many of today's tax-exempt organizations may be nonprofit because their

[75]Hansmann, "The Role of Nonprofit Enterprise," 89 *Yale L.J.* 835, 896 (1980).
[76]*Id.* at 844.
[77]*Id.* at 847.
[78]*Id.* at 845.
[79]*Id.* at 843.

forebears started out as such. In addition, the forces of pluralism of institutions and organizations continue to shape much of the contemporary independent sector.

(c) Freedom of Association

Tax exemption for nonprofit membership organizations may be viewed as a manifestation of the constitutionally protected right of association accorded the members of these organizations. There are two types of *freedom of association*. One type—termed the *freedom of intimate association*—is the traditional type of protected association derived from the right of personal liberty. The other type—the *freedom of expressive association*—is a function of the right of free speech protected by the First Amendment to the U.S. Constitution.

By application of the doctrine of freedom of intimate association, the formation and preservation of certain types of highly personal relationships are afforded a substantial measure of sanctuary from unjustified interference by government.[80] These personal bonds are considered to foster diversity and advance personal liberty.[81] In assessing the extent of constraints on the authority of government to interfere with this freedom, a court must make a determination of where the objective characteristics of the relationship, which is created when an individual enters into a particular association, are located on a spectrum from the most intimate to the most attenuated of personal relationships.[82] Relevant factors include size, purpose, policies, selectivity, and congeniality.[83]

The freedom to engage in group effort is guaranteed under the doctrine of freedom of expressive association[84] and is viewed as a way of advancing political, social, economic, educational, religious, and cultural ends.[85] Government, however, has the ability to infringe on this right when compelling state interests are served that are unrelated to the suppression of ideas and that

[80] Pierce v. Society of Sisters, 268 U.S. 510 (1925); Meyer v. Nebraska, 262 U.S. 390 (1923).

[81] Zablocki v. Redhail, 434 U.S. 374 (1978); Quilloin v. Walcott, 434 U.S. 246 (1978); Smith v. Organization of Foster Families, 431 U.S. 816 (1977); Carey v. Population Serv. Int'l., 431 U.S. 678 (1977); Moore v. East Cleveland, 431 U.S. 494 (1977); Cleveland Bd. of Educ. v. LaFleur, 414 U.S. 632 (1974); Wisconsin v. Yoder, 406 U.S. 205 (1973); Stanley v. Illinois, 405 U.S. 645 (1972); Stanley v. Georgia, 394 U.S. 557 (1969); Griswold v. Connecticut, 381 U.S. 479 (1965); Olmstead v. United States, 277 U.S. 438 (1928).

[82] Runyon v. McCrary, 427 U.S. 160 (1976).

[83] Roberts v. United States Jaycees, 468 U.S. 609 (1984).

[84] Rent Control Coalition for Fair Housing. v. Berkeley, 454 U.S. 290 (1981).

[85] Boy Scouts of America et al. v. Dale, 530 U.S. 640 (2000); NAACP v. Claiborne Hardware Co., 458 U.S. 886 (1982); Larson v. Valente, 456 U.S. 228 (1982); In re Primus, 436 U.S. 412 (1978).

cannot be achieved through means significantly less restrictive of associational freedoms.[86]

These two associational freedoms have been the subject of a U.S. Supreme Court analysis concerning an organization's right to exclude women from its voting membership.[87] The Court found that the organization involved and its chapters were too large and unselective to find shelter under the doctrine of freedom of intimate association. Although the Court also conceded that the "[f]reedom of association therefore plainly presupposes a freedom not to associate," it concluded that the governmental interest in eradicating gender-based discrimination was superior to the associational rights of the organization's male members.[88] In general, the Court held that to tolerate this form of discrimination would be to deny "society the benefits of wide participation in political, economic, and cultural life."[89]

§ 1.4 STATISTICAL PROFILE OF CHARITABLE SECTOR

The charitable sector and the federal tax law with respect to it have a common feature: enormous and incessant growth. This expansion is reflected in all of the principal indicators pertaining to this sector, including the number of organizations, the sector's asset base, the amount of charitable giving and granting, its annual expenditures, its share of the gross domestic product, and the size of its workforce. There is, however, this direct correlation: as the nonprofit sector expands, so too does the body of federal and state law regulating it. No end to either of these expansions is in sight.[90]

Over the years, there have been many efforts to analyze and portray the nonprofit sector. One of the first of these significant undertakings, utilizing statistics, conducted jointly by the Survey Research Center at the University of Michigan and the U.S. Census Bureau, was published in 1975 as part of the findings of the Commission on Private Philanthropy and Public Needs.[91] The data

[86] Brown v. Socialist Workers '74 Campaign Committee, 459 U.S. 87 (1982); Democratic Party v. Wisconsin, 450 U.S. 107 (1981); Buckley v. Valeo, 424 U.S. 1 (1976); Cousins v. Wigoda, 419 U.S. 477 (1975); American Party v. White, 415 U.S. 767 (1974); NAACP v. Button, 371 U.S. 415 (1963); Shelton v. Tucker, 364 U.S. 486 (1960); NAACP v. Alabama, 347 U.S. 449 (1958).

[87] Roberts v. United States Jaycees, 468 U.S. 609 (1984).

[88] *Id*. at 622–629.

[89] *Id*. at 625. In general, see *Tax-Exempt Organizations* § 1.7; Hopkins, *Tax-Exempt Organizations and Constitutional Law: Nonprofit Law as Shaped by the U.S. Supreme Court* (Hoboken, NJ: John Wiley & Sons, 2012) § 1.9.

[90] "The rapid growth of the nonprofit sector in the last half century has led to greatly increased attention from the media, scholars, the government, and the public." O'Neill, *Nonprofit Nation: A New Look at the Third America* 34 (San Francisco: Jossey-Bass, 2002) (*Nonprofit Nation*).

[91] *Report of the Commission on Private Philanthropy and Public Needs: Giving in America—Toward a Stronger Voluntary Sector* (1975).

compiled for the commission's use were for 1973. Contemporary charitable giving statistics are explored in the following pages, but one striking basis of comparison cannot be resisted at this point. Charitable giving in that year was $26 billion, while for 2019 the amount was nearly $450 billion.[92]

Research of this nature developed for the commission spawned recurring statistical portraits of the sector. One of the most comprehensive of these analyses is that provided in the periodic almanac published by the Urban Institute.[93] Others include a fascinating portrait of the "third America"[94] and the annual survey of charitable giving published by the Giving USA Foundation.[95] The IRS's Statistics of Income Division collects data on tax-exempt organizations.[96] Further, various subsets of the nonprofit sector are the subject of specific portrayals.[97]

The nonprofit sector in the United States is not uniformly labeled; it goes by many names. In addition to *nonprofit*, adjectives used include *tax-exempt*, *voluntary*, *nongovernmental*, *independent*, and *voluntary*.[98] (In the author's view, *nonprofit sector* endures as the sturdiest of the terms.) In its most expansive definition, the nonprofit sector comprises all tax-exempt organizations and some entities that cannot qualify for exemption. The Independent Sector organization defined the *independent sector* as all charitable[99] and social welfare organizations.[100]

As Independent Sector defined the sector, it is comprised of "many, varied" organizations, such as "religious organizations, private colleges and

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[92]See text accompanied by *infra* note 126.

[93]The most recent version of this almanac is Wing, Pollak, & Blackwood, *The Nonprofit Almanac 2008* (Washington, DC: The Urban Institute Press) (*Nonprofit Almanac*).

[94]*Nonprofit Nation*.

[95]These annual publications of this organization are titled *Giving USA*.

[96]The IRS publishes various editions of the Statistics of Income Bulletins.

[97]E.g., *Yearbook of American and Canadian Churches* (National Council of the Churches of Christ in the United States of America, various editions); *Foundation Giving: Yearbook of Facts and Figures on Private, Corporate and Community Foundations* (The Foundation Center, various editions); *Foundation Management Report* (Council on Foundations, various editions). The American Hospital Association publishes statistics concerning hospitals; the National Center for Education Statistics publishes data on independent colleges and universities; and the American Society of Association Executives publishes information concerning the nation's trade, business, and professional associations. There are several other analyses of this nature.

[98]Indeed, there is little uniformity as to this term. See text accompanied by *supra* note 7.

[99]That is, organizations that are tax-exempt pursuant to IRC § 501(a) because they are described in IRC § 501(c)(3) (see *Tax-Exempt Organizations* pt. 3).

[100]That is, organizations that are tax-exempt pursuant to IRC § 501(a) because they are described in IRC § 501(c)(4) (see *Tax-Exempt Organizations* ch. 13). This definition of the independent sector is in the 2002 edition of the *Nonprofit Almanac* at 7–8. Today, the *Nonprofit Almanac* does not attempt a definition of the sector but instead surveys the "nonprofit landscape" (*Nonprofit Almanac* at 3–5).

schools, foundations, hospitals, day care centers, environmental organizations, museums, symphony orchestras, youth organizations, advocacy groups, and neighborhood organizations, to name a few." This analysis continued: "What is common among them all is their mission to serve a public purpose, their voluntary and self-governing nature, and their exclusion from being able to distribute profits to stockholders."[101]

Any assessment of any consequence of the nonprofit sector includes a discussion of the number of organizations in the sector. Nonetheless, it is "surprisingly difficult to answer the seemingly simple question, How many nonprofit organizations are there in the United States?"[102] The simple answer is: millions. There are "several million" nonprofit organizations, although "no one really knows how many."[103]

Most nonprofit organizations are tax-exempt entities, however, and the number of those entities is in excess of two million. The IRS's data for the federal government's fiscal year 2019 reflect 1,718,233 recognized conventional exempt organizations.[104] Of these, 1,365,744 are charitable, educational, religious, scientific, and similar entities. Other categories of exempt organizations include social welfare organizations (79,808),[105] trade associations and other types of business leagues (62,700),[106] social and recreational clubs (49,126),[107] labor and agricultural organizations (45,888),[108] fraternal beneficiary societies (41,756),[109] veterans' organizations (28,575),[110] and cemetery companies (9,406).[111] Exempt organizations filed 1,118,006 annual information returns and similar forms in that year.[112]

In an understatement, the observation was made that "[m]easuring the number of organizations in the independent sector is a complex activity, largely because of the diversity of its components."[113] There are several reasons for this. One reason is that church organizations (of which there are an estimated

[101] *Nonprofit Almanac* (2002) at 3.
[102] *Nonprofit Nation* at 8.
[103] *Id*. at 1.
[104] That is, organizations that are tax-exempt pursuant to IRC § 501(c).
[105] *Tax-Exempt Organizations* ch. 13.
[106] *Id*. ch. 14.
[107] *Id*. ch. 15.
[108] *Id*. ch. 16.
[109] *Id*. § 19.4(a).
[110] *Id*. § 19.11(a).
[111] *Id*. § 19.6.
[112] IRS 2019 Data Book (issued on June 29, 2020).
[113] *Nonprofit Nation* at 8. The point was articulated more forcefully in the fifth edition (1996) of the *Nonprofit Almanac*, where it was stated that "[c]ounting the number of institutions in the independent sector is a challenge" (*Nonprofit Almanac* at 25). Even with a complete and accurate tally, difficulties continue: "Trying to understand the various exempt organizations provisions of the Internal Revenue Code is as difficult as capturing a drop of

350,000[114]) are not required to file annual information returns with the IRS,[115] so data concerning them is difficult to amass. Also, hundreds of organizations fall under a group exemption[116] and thus are not separately identified. Further, smaller nonprofit organizations need not seek recognition of tax exemption from the IRS.[117] Small organizations are not required to file annual information returns with the IRS but are required to electronically file a short notice as to their existence.[118]

Because a "price cannot be placed on the output of most nonprofit organizations," their percentage of the gross domestic product is difficult to assess; the best estimate is that it is about 5 percent.[119] When the measure is in terms of wages and salaries paid, the percentage rises to approximately 8 percent.[120] Other ways to measure the size of the sector are its revenue (about $1,006.7 billion in 2006),[121] its outlays (about $915.2 billion in 2005),[122] and its paid employment (12.9 million individuals in 2005).[123] Most of the sector's revenue is in the form of fees for services provided, followed by contributions and grants.[124] As to outlays (2006 data), the funds are expended by the organizations (88.7 percent), granted (8 percent), or invested or used as a buffer for cash flow (3.3 percent).[125]

Charitable giving in the United States in 2019 is estimated to have totaled $449.64 billion.[126] Giving by individuals in 2019 amounted to an estimated $309.66 billion; this level of giving constituted 69 percent of all charitable giving for the year. Grantmaking by private foundations is an estimated $75.69 billion (17 percent of total funding). Gifts in the form of charitable bequests in 2019 are estimated to be $43.21 billion (10 percent of total giving). Gifts from

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mercury under your thumb" (Weingarten v. Commissioner, 86 T.C. 669, 675 (1986), *rev'd (on other grounds)*, 825 F.2d 1027 (6th Cir. 1987).

[114] *Nonprofit Almanac* at 139. The term *church* includes analogous religious congregations, such as temples and mosques. See *Tax-Exempt Organizations* § 10.3.

[115] See *Tax-Exempt Organizations* § 28.2(b)(i).

[116] See *Tax-Exempt Organizations* § 26.11.

[117] These are organizations that normally do not generate more than $5,000 in revenue. See *Tax-Exempt Organizations* § 28.2(b)(ii).

[118] See *Tax-Exempt Organizations* § 28.3.

[119] *Nonprofit Nation* at 9.

[120] *Id*. at 10.

[121] *Id*. at 115.

[122] *Id*.

[123] *Id*. at 18, 27.

[124] *Id*. at 115. Fees for services and goods were estimated to be 70.3 percent of the total; contributions and nongovernment grants were said to be 12.3 percent of the total (*id*. at 143–144).

[125] *Id*. at 121.

[126] These data are from *Giving USA 2020*, published by the Giving USA Foundation, and researched and written by the Center on Philanthropy at Indiana University.

corporations in 2019 totaled $21.09 billion (5 percent of total giving for that year).

Contributions to religious organizations in 2019 totaled $128.17 billion (29 percent of all giving that year). Gifts to educational organizations amounted to $64.11 billion (14 percent); to human service entities, $55.99 billion (12 percent); to foundations, $53.51 billion (12 percent); to health care institutions, $41.46 billion (9 percent); to public/society benefit organizations, $37.16 billion (8 percent); to international affairs entities, $28.99 billion (6 percent); to arts, culture, and humanities entities, $21.64 billion (5 percent); and to environment and animals groups, $14.16 billion (3 percent).

According to the most recent IRS data, total noncash charitable contributions increased by 15 percent from $64 billion in 2015 to $73.6 billion in 2016.[127] The average noncash contribution amount per tax return increased from $7,607 to $8,509 during this period. The number of individual returns filed with a Form 8283[128] increased by 2.8 percent from 8.4 million for 2015 to 8.7 million for 2016.

Contributions of corporate stock represented the largest share of total noncash gifts, in terms of value claimed. For 2016, corporate stock donations totaled $32.7 billion, an increase of 13.2 percent from 2015, representing 44.4 percent of all these donations. The average stock contribution per return in 2016 was $199,939. Gifts of clothing ($11.5 billion) constituted the second-largest category; the average such gift per return was $1,765.

All adjusted gross income groups with incomes above $100,000 reported increases in deducted noncash contributions. The largest increase was by taxpayers in the $5 million–under $10 million group, who contributed $5.5 billion in value in 2016, an increase over the prior year of 37.9 percent. Taxpayers in the $10 million-or-more income group contributed 38.1 percent of all noncash gifts, or $28.1 billion.

Private foundations received the largest share of these contributions, in the amount of $18.4 billion (25.1 percent of the total). The average of these gifts is $213,661 (the highest average gift amount for all types of charities). The next-largest type of charitable recipient was "large organizations"; they received $16.6 billion in noncash gifts.

Donors aged 65 and over contributed the most, giving $27.8 billion (37.7 percent of the total); this is an average of $16,030 per return. Contributions of stock, mutual funds, and other investments by these taxpayers (the largest type of gift for this group) were $17.9 billion, representing 48 percent of the total amount.

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[127]IRS, "Individual Noncash Charitable Contributions, Tax Year 2016," *Statistics of Income Bulletin* (Pub. 5337 (rev. May, 2019).

[128]See § 22.7(a).

Here are some other perspectives on the nonprofit sector: it (1) has more civilian employees than the federal government and the 50 state governments combined; (2) employs more people than any of the following industries: agriculture; mining; construction; transportation, communications and other public utilities; and finance, insurance, and real estate; and (3) generates revenue that exceeds the gross domestic product of all but six foreign countries: China, France, Germany, Italy, Japan, and the United Kingdom.[129]

Statistics, of course, cannot provide the entire nonprofit sector picture. As the Commission on Private Philanthropy and Public Needs observed (albeit nearly 50 years ago), the "arithmetic of the nonprofit sector finds much of its significance in less quantifiable and even less precise dimensions—in the human measurements of who is served, who is affected by nonprofit groups and activities." The Commission added:

> In some sense, everybody is [served or affected by the sector]: the contributions of voluntary organizations to broadscale social and scientific advances have been widely and frequently extolled. Charitable groups were in the forefront of ridding society of child labor, abolitionist groups in tearing down the institution of slavery, civic-minded groups in purging the spoils system from public office. The benefits of non-profit scientific and technological research include the great reduction of scourges such as tuberculosis and polio, malaria, typhus, influenza, rabies, yaws, bilharziasis, syphilis and amoebic dysentery. These are among the myriad products of the nonprofit sector that have at least indirectly affected all Americans and much of the rest of the world besides.
>
> Perhaps the nonprofit activity that most directly touches the lives of most Americans today is noncommercial "public" television. A bare concept twenty-five years ago, its development was underwritten mainly by foundations. Today it comprises a network of some 240 stations valued at billions of dollars, is increasingly supported by small, "subscriber" contributions and has broadened and enriched a medium that occupies hours of the average American's day.

More particularly benefited by voluntary organizations are the one-quarter of all college and university students who attend private institutions of higher education. For hundreds of millions of Americans, private community hospitals, accounting for half of all hospitals in the United States, have been, as one Commission study puts it, "the primary site for handling the most dramatic of human experiences—birth, death, and the alleviation of personal suffering." In this secular age, too, it is worth noting that the largest category in the nonprofit sector is still very large indeed; nearly two out of three Americans belong to and evidently find comfort and inspiration in the nation's hundreds of thousands of religious organizations. All told, it would be hard to imagine American

[129] *Nonprofit Nation* at 12.

life without voluntary nonprofit organizations and associations, so entwined are they in the very fabric of our society, from massive national organizations to the local Girl Scouts, the parent-teacher association, or the bottle recycling group.[130]

§ 1.5 HISTORY OF CHARITABLE CONTRIBUTION DEDUCTION

The federal income tax charitable contribution deduction is now more than 100 years of age. Enacted in 1917, it has evolved significantly, with changes in its contours ranging from major to minor over the ensuing decades. In a remarkable understatement, one observer wrote that, over the years, "[a]lthough the basic premise remains the same," the charitable deduction has changed from a "short statutory provision into a complex set of rules."[131]

The major changes in the charitable deduction for individuals over the period generally entail the limitations on the amount that can be deducted by donors in a year (increasing from 15 to 60 percent), the creation of "preferred" categories of charitable donees, the differing treatment of gifts to public charities and private foundations, the rules concerning the deductibility of property that appreciated in value, the addition of substantiation and appraisal rules, and codification of the concept of the donor-advised fund.[132] This aspect of the law is also informed by the breadth of the range of organizations that are considered charitable entities for purposes of the deduction.[133]

The federal income tax charitable contribution deduction was enacted as part of the War Income Tax Revenue Act of 1917.[134] That body of law increased federal income tax rates for the purpose of paying for the United States' involvement in World War I. This deduction, however, was not enacted for lofty purposes such as incentivizing giving for charitable and like causes. Rather, it was created to "offset the potential negative effects of increased

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[130] *Report of the Commission on Private Philanthropy and Public Needs: Giving in America—Toward a Stronger Voluntary Sector* at 34–48 (1975).

[131] Lindsey, "The Charitable Contribution Deduction: A Historical Review and a Look to the Future," 81 *Neb. L. Rev*. (no. 3) 1056, 1057 (2002). This point is substantially overstated in Duquette, "Founders' Fortunes and Philanthropy: A History of the U.S. Charitable-Contribution Deduction," 93 *Business History Rev*. 553 (Autumn 2019), where it is written that the "workings of the [charitable] deduction have changed little since its creation in 1917" (*id*.). Also Taggart, "The Charitable Deduction," 26 *Tax L. Rev*. 63 (1970).

[132] Cf.: "Direct changes to the contribution deduction since its enactment have been few and relatively modest" (Duquette, *supra* note 131, at 559).

[133] "There are a wide variety of organizations to which a taxpayer can donate money or property and receive a charitable contribution deduction" (Lindsey, *supra* note 131, at 1057).

[134] Pub. L. No. 65-50.

income taxes on charitable giving among the wealthy."[135] Some legislators "feared that the [tax] increase would reduce individuals' income 'surplus' from which they supported charity," in that "[i]t was thought that a decrease in private support would create an increased need for public support and even higher tax rates, so the [charitable] deduction was offered as a compromise."[136] In short, "some policymakers were concerned that without the charitable deduction, wealthy taxpayers subjected to these higher tax rates would no longer contribute to charities or institutions of higher education (or would contribute less)."[137] The overall amount of giving that could be deducted was set at 15 percent of a donor's net taxable income.

The Individual Income Tax Act of 1944[138] revised the maximum amount that could be deducted, by changing the measuring base from net taxable income to adjusted gross income, and introduced the standard deduction. The maximum amount deductible was increased in 1952 when the percentage limitation on deductible giving was upped to 20 percent.[139] In 1954, Congress raised this limitation to 30 percent but only for certain specified categories of eligible organizations.[140] A commentator stated that this was the "first time that Congress encouraged certain charitable giving by granting more generous deductions for donations to certain charitable organizations than to others . . . [to] encourage additional contributions to these organizations to offset their rising costs and modest returns on endowment funds."[141] This list was expanded by the Revenue Act of 1964,[142] along with the introduction of an unlimited charitable contribution deduction for certain high-giving taxpayers.

The Tax Reform Act of 1969[143] brought substantial changes in this area. The list of "preferred" charities was expanded, as was the scope of the charitable deduction with respect to them. The unlimited charitable deduction was phased out. Many other substantive provisions were introduced, such as the

[135]Congressional Research Service, "The Charitable Deduction for Individuals: A Brief Legislative History (R46178) 4 (Jan. 14, 2020). "The Congress added a deduction for gifts to charitable organizations to the bill implementing these high rates, not to *encourage* the wealthy to give their fortune away (which the most influential and richest men were already doing) but to *not discourage* their continued giving in light of a larger tax bill" (Duquette, *supra* note 131, at 558).

[136]Joint Committee on Taxation, *Present Law and Background Relating to the Federal Tax Treatment of Charitable Contributions* (JCX-55-11) 4 (Oct. 14, 2011).

[137]Congressional Research Service, *supra* note 135, at 5.

[138]Pub. L. No. 78-315.

[139]Pub. L. No. 82-465.

[140]Pub. L. No. 83-591.

[141]This was the "first time that Congress encouraged certain charitable giving by granting more generous deductions for donations given to certain charitable organizations than to others" (Lindsey, *supra* note 131, at 1063).

[142]Pub. L. No. 88-272.

[143]Pub. L. No. 91-172.

private foundation rules (with their attendant lesser deductibility limitations), various rules by which the charitable deduction for gifts of certain properties had to be reduced, a basis allocation rule for bargain sales, and the law concerning charitable remainder trusts.

The Economic Recovery Act of 1981[144] introduced an above-the-line charitable deduction—a charitable deduction for those who also utilized the standard deduction. This deduction expired in 1986. At the time of its enactment, it was controversial. For example, the then-Assistant Secretary of the Treasury for Tax Policy argued that this deduction "would go, in very large measure, to those who are already giving with respect to their existing gifts,"[145] providing them with a windfall gain, adding that the deduction "would result in a large revenue loss to the Treasury and little increased giving for the charities."[146] Congress disagreed, "[b]elieving that allowing a charitable deduction to nonitemizers stimulates charitable giving, thereby providing more funds for worthwhile nonprofit organizations, many of which provide services that otherwise might have to be provided by the Federal government."[147]

The Deficit Reduction Act of 1984[148] increased the contribution limit on contributions of cash or ordinary income property to standard grantmaking private foundations. That legislation also introduced substantiation requirements, for claimed deductions of property in excess of $2,000, and penalties for overvaluation of property. The Technical and Miscellaneous Revenue Act of 1988[149] introduced rules by which a charitable contribution deduction could arise for payments providing a right to purchase athletic tickets (repealed in 2017) and for corporate gifts of inventory when used in particular instances.

In 1993, Congress passed the Omnibus Budget Reconciliation Act of 1993,[150] which revised the substantiation rule by reducing the value of the gift amount to $250 and introduced the $75 *quid pro quo* contribution rule. The Small Business Job Protection Act, adopted in 1996,[151] introduced the qualified appreciated stock rule for private foundations; that rule was made permanent on passage of the Tax and Trade Relief Extension Act of 1998.[152]

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[144]Pub. L. No. 97-34.

[145]Senate Committee on Finance, *Statement of Donald C. Lubick, Assistant Secretary for Tax Policy, U.S. Treasury Department*, Hearings Before the Subcommittee on Taxation and Debt Management Generally of the Committee on Finance on S. 219, 96th Cong., 2nd Sess. 51 (Jan. 30, 1980)).

[146]*Id*. at 68.

[147]Joint Committee on Taxation, *General Explanation of the Economic Recovery Act of 1981* (JCS-71-81) 49 (Dec. 29, 1981).

[148]Pub. L. No. 98-369.

[149]Pub. L. No. 100-647.

[150]Pub. L. No. 103-66.

[151]Pub. L. No. 104-188.

[152]Pub. L. No. 105-277.

The Pension Protection Act of 2006[153] brought a series of rules adversely impacting the extent of charitable contributions to certain supporting organizations and codified the concept of the donor-advised fund. This latter law change led to considerable and ongoing controversy about deductible charitable giving to vehicles where the money and property are not always put to immediate programmatic charitable use (as is also the case with, for example, endowment funds and charitable remainder trusts).

The Tax Cuts and Jobs Act,[154] enacted in 2017, had a minor direct impact on charitable giving and a major indirect impact on giving. As to its direct impact, the law was changed to increase the AGI limit for cash gifts by individuals to public charities from 50 percent to 60 percent. The indirect impact came in the form of enactment of provisions outside the ambit of the charitable deduction itself: lowering of individual tax rates, doubling of the standard deduction, and adjustments in the estate tax rules, which seem to be leading to a decline in charitable giving by individuals.[155]

Although the federal income tax charitable contribution deduction has endured criticisms over the years, and continues to do so, the "charitable contribution tax incentive has continued vitality insofar as it encourages people to make charitable donations throughout the year."[156]

§ 1.6 CHARITABLE CONTRIBUTION DEDUCTION REFORM PROPOSALS

Leaving aside the inevitable tweaks, reform proposals concerning the federal income tax charitable contribution deduction for individuals are of three types: harmonizing the various percentage limitations on annual deductible giving (including minimizing the distinctions in eligible deductible giving between gifts to public charities and gifts to private foundations), making the charitable deduction more "equitable" (read: making it available to nonitemizers), and converting the deduction to (or establishing as an alternative to) a tax credit.

A report commissioned by Independent Sector[157] analyzed five tax policy proposals involving amounts of charitable giving and the number of

[153]Pub. L. No. 109-135.

[154]Pub. L. No. 115-97.

[155]The U.S. Tax Court, in 2020, observed that, "[i]n the past 34 years Congress has amended section 170 more than 30 times" (Oakbrook Land Holdings, LLC v. Commissioner, T.C. Memo. 2020–54 (2020)). Footnote 5 in that opinion contains the public law citations for each of these amendments.

[156]Lindsey, *supra* note 131, at 1059.

[157]This report, published in mid-2019, was researched and written by the Indiana University Lilly Family School of Philanthropy. It was funded by the Charles Stewart Mott Foundation and the Fidelity Charitable Trustees' Initiative.

households that contribute. These proposals are: a nonitemizer charitable deduction without limitations, a nonitemizer charitable deduction with a cap ($4,000 for single filers and $8,000 for married couples filing jointly), a nonitemizer charitable deduction with a floor (allowing a deduction of 50 percent of the value of charitable gifts under 1 percent of AGI and a full deduction for gifts over 1 percent of AGI), an enhanced nonitemizer charitable deduction providing a higher-value deduction for low- and middle-income households, and a nonrefundable charitable giving tax credit (25 percent).

The key findings of this report are:

- The tax credit option has the largest positive impact on the amount that would be contributed ($37 billion) and the number of participating households (10.6 million). This proposal would reduce federal tax revenues by $33 billion.
- The unlimited nonitemizer charitable deduction could generate up to $26 billion in additional charitable contributions and induce up to 7.3 million additional households to donate. The federal revenue loss would be as much as $22 billion.
- The nonitemizer charitable deduction with a cap would generate fewer additional charitable dollars than is lost to the federal fisc.
- The nonitemizer charitable deduction with a floor could bring in up to $7 billion more in charitable giving than is lost in federal revenue. This policy option would cause an increase in giving households by as many as 352 per million lost in federal revenue.

Subsequently, the Joint Economic Committee issued a similar report.[158] One of its reform options is to make the charitable deduction available to itemizers and nonitemizers. This approach, it is said, would increase charitable giving but decrease federal revenue. The JEC report cited a study showing that an above-the-line charitable deduction would have increased giving in 2018 by $21.5 billion and reduced that year's government revenue by $25.8 billion.

The report concludes this portion of its analysis with the observation that, "[w]hile an above-the-line deduction would treat lower-income donors more fairly with respect to their charitable giving, it would still result in their having a higher after-tax price of giving compared with today's itemizers."[159] The report continues: "Because higher-income taxpayers generally have higher tax rates, the effective cost of their donations would still be lower."[160]

[158]Joint Economic Committee (Republicans), "Reforming the Charitable Deduction," as part of its Social Capital Project (Report no. 2 (Nov. 2019)).

[159]*Id*. at 14.

[160]*Id*.

The JEC report also addresses the matter of a tax credit, noting that, for example, with a 25 percent charitable credit, a donor's tax liability would be reduced by 25 percent of the value of all gifts, regardless of the tax rates or the size of the gifts. However, the report adds that, unless made refundable, this credit would apply only to the extent the donor has tax liability.

The same study estimated that replacing the charitable deduction with a 25 percent nonrefundable tax credit would have a greater positive impact on charitable giving and a greater reduction in federal revenue than the above-the-line deduction: it would have increased giving in 2018 by $23.3 billion and reduced revenue by $31.1 billion.

The JEC report stated that a credit approach has also been estimated to have a larger positive effect on the number of new donors compared to an above-the-line deduction. Another study cited by the committee, of various ways to penalize giving less among nonitemizers while leaving the current deduction unchanged, found that a 25 percent tax credit, of the options considered, "would most increase the number of households giving, both overall and at all income levels except the top 1 percent."[161]

As to the percentage limitations, a good case can be made that the various existing percentages (from 20 to 60 percent) are confusing and unnecessary, and need to be blended and trimmed.

With a progressive tax system, it is inevitable that the tax benefits of a deduction are likely to accrue to the wealthier of taxpayers. Thus, one commentator lamented the "disparate treatment between taxpayers who itemize their tax returns [sic] and those who claim the standard deduction."[162] Another observer stated that the charitable deduction "has almost always disproportionately benefited a relatively high-income minority of households."[163] Those finding this to be a great inequity often fail to understand that a form of charitable deduction is built into the standard deduction. In any event, an above-the-line charitable deduction is an expensive undertaking for the federal government. It is not likely to be tried again soon.

From time to time, as noted, a tax credit is considered as an alternative or a supplement to the charitable contribution deduction for individuals. Tax credits of this nature, also as noted, can be costly from the standpoint of the federal fisc. Further, studies have shown that a federal charitable tax credit would significantly alter the allocation of gift dollars to types of charities in relation to the way these dollars are directed to charity under the current federal income tax charitable contribution deduction system.

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[161] *Id*.

[162] Lindsey, *supra* note 131, at 1092.

[163] Duquette, *supra* note 131, at 577.