Charitable Waste: Consideration of a "Waste Not, Want Not" Tax

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Lavish expenditures by charities occur regularly, even in today’s depressed economy. Many are unwarranted and foolish while some prove to be extremely beneficial and valuable over time. But even the best of charitable splurges involve government waste since all charities are substantially supported by significant government subsidies. Unfortunately, most taxpayers don’t respond to charitable luxury-type waste with the same degree of outrage they do to other forms of government waste. This article first reveals the probable reasons for this different taxpayer reaction and posits that it’ll be difficult to change taxpayer response given the complexity of the perception problems. As an alternative, this article proposes a tax solution to the problem, after describing how existing laws are currently inadequate to the task of preventing or curbing lavishness by charities. Moreover, the article articulates why flat prohibitions or oppressive sanctions are unwarranted and proposes taxing only the excess amount of charitable expenditures without threat, judgment or blame about a charity’s worthiness for general tax-exemption. A chief difficulty is in defining wastefulness. This article offers criteria for the tax’s design that tackles this issue as well as other considerations.

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INTRODUCTION

[Expletive deleted]. No need to mince words. Taxpayers hate, despise, revile, etc., government waste. That’s why government outlays for items or services widely viewed as significantly over-priced, high-end luxury and/or clearly frivolous are extremely newsworthy, regularly grabbing prime placement as headline leads.\(^1\) But not all government-financed waste is equal in terms of the attention received or corrective measures taken or available to stop the abuse. Specifically, the inappropriate (though still legal\(^2\)) charitable\(^3\) excessive/exorbitant expenditure type waste, herein called “ILCEE waste,”\(^4\) that’s the focus of this article, is treated differently, despite the fact that charities are significantly publicly subsidized by huge tax breaks.\(^5\) Consider, for example, the following actual situations of government-financed waste, categorized by type, with specific comparative focus on the charitable waste in the fourth category.

1. Wasteful Government Budget Allocations: Congress recently authorized $2.5 billion for 10 more C-17 transport airplanes despite the Pentagon telling Congress it didn’t need or want them because it had adequate supply of these planes.\(^6\) In another example, MidAmerica St. Louis Airport, significantly funded by federal dollars, cost $213 million to build but it’s sat empty and unused for years at a cost of $4-5 million per year.\(^7\)

2. Excessive Government Payments to Contractors – In 2004 the federal government paid startling amounts of money to government military contractor, Halliburton Co., (which had an unusual no bid contract with the government), for significantly over-priced items, like $50,000 per month for just soda at an astonishing

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2 See discussion infra Part I. A.1.

3 See infra, note 26 about what’s meant by the term “charity” and more generally, Part I.A.2 about the reason for the focus on charitable waste.

4 See infra Parts I. A.1-2 for further elaboration of this acronym.

5 See infra Parts I. B.1-2 for elaboration of the types and approximate values of the primary subsidies.


cost of $45 a case. In a situation involving another contractor, in the 6 months between June 2006 and January 2007, due to poor FEMA oversight, a contractor earned an excess $1.5 million in profit because it charged the government $200 more than its $45 cost per service to provide septic cleaning to 61 trailers at a Hurricane Katrina park three times a week.

3. Inappropriate Bailout Conduct and Uses - In the flurry of the economy-is-going-off-the-cliff mindset of late 2008 to early 2009, automaker executives flew to congressional meetings in D.C. on expensive private jets (rather than commercial flights) to ask for taxpayer bailouts. Subsequently, shortly after the automobile industry and bank bailouts were passed, taxpayers learned that tax-funded bailout monies were used to finance lavish retreats and pay huge bonuses to executives of bailed-out companies.

4. Lavishness by Charities - In 2001, in the aftermath of the Enron corporate scandal, shareholders, like now, were infuriated at extravagance by public, for-profit companies. But excesses like the regular use by the trustee of the Arthur S. Demos Foundation, a charitable nonprofit, of its corporate private jet to fly to business meetings went virtually unnoticed. The Demos Foundation spent $36 million to buy the 12-seat, transoceanic jet in 2001 – and millions more to own and operate two prior jets two decades before. Similar extravagance is revealed by huge salaries paid by numerous

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16 Id.
charities to CEOs, key employees, winning college football coaches, physicians and money managers. The breath and amounts of these salaries are so significant they’ve spawned what Forbes, the financial magazine, calls a class of “nonprofit millionaires,” citing, for example, the $3.7 million paid to Duke University’s head men’s basketball coach and the $2.7 million salary for the director of New York’s Museum of Modern Art in 2008.

All the above have four commonalities that also provide some parameters of the ILCEE waste discussed in this article. They each involve expenditures that: a) were entirely or significantly government-financed; b) would be considered unquestionably exorbitant/frivolous by most taxpayers and thus politically indefensible and intolerable if paid by the government directly; and c) are all perfectly legal, and d) therefore, only correctable by force of taxpayer political persuasion, influence, and outrage rather than by formal legal recourse for damages, penalties or repayment sanctions.

It’s the latter commonality that also highlights the primary difference between the fourth category, relating to charitable expenditures, and the other forms of government waste – the relative lack of taxpayer outrage over the exorbitance of the government-financed expenditures by charities. News accounts of charity excesses, like those involving the Demos Foundation, high salaries and other exorbitant expenses by charities do not engender the same level of taxpayer outrage and political forces for correction as do the other three types of government waste. But charitable waste is definitely a problem that deserves solution. As observed by esteemed trust law scholar Professor Edward Halbach, there’s an “increasingly frequent problem of trust funds that have become excessive for their stated charitable purposes.”

Why this difference in taxpayer reaction, particularly when similar facts are involved as for the other categories (e.g., use/abuse of private jets and high compensation)? A simple answer is that most taxpayers are unaware of how significant not-for-profit, tax-exempt organizations (herein “nonprofits”) are to the vibrancy of the

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17 Yes, most private colleges and universities are charities too. Internal Revenue Code [hereinafter I.R.C.] § 501(c) (3). Also, see infra note 27 and generally Sara E. Waldeck, The Coming Showdown Over University Endowments: Enlisting the Donors, 77 FORDHAM L. REV. 1795.

18 Amy Bell, Nonprofit Millionaires, FORBES.COM, Dec. 17, 2009 [hereinafter FORBES, Nonprofit Millionaires], http://www.forbes.com/2009/12/17/nonprofits-biggest-salaries-personal-finance-millionaires_print.html (discussing the extensive CHRONICLE OF PHILANTHROPY 2009 pay survey of executive compensation at charities, including as examples, in addition to those cited in the text, the $4.3 million paid to Yale University’s chief investment officer and also to University of Southern California’s head football coach, respectively, the $3.4 million paid to the CEO of Partners Healthcare System, and the $1.2 million and more paid to the Presidents of New York University, Columbia University, and the University of Pennsylvania). See also Jill S. Manny, Nonprofit Payments to Insiders and Outsiders: Is the Sky the Limit?, 76 FORDHAM L. REV. 735 (2007), at 736-737.

19 Id.

20 Wastefulness is not typically a violation of law unless expenditures are considered fraudulent or exceed “reasonableness” as measured by market rates. E.g., see Bernard Stamler, Accountability: The Gray Area for Nonprofits, Where Legal is Questionable, N.Y. TIMES, Nov. 17, 2003, at F1, and FORBES, Nonprofit Millionaires, supra note 17.

21 See Healy, supra note 15, noting that “big-ticket expenses go virtually unnoticed in the world of philanthropy, even though foundations are publicly subsidized through …tax breaks.”


23 For purposes of this article, the terms “not-for-profit” or “nonprofit” organization are used interchangeably with “tax-exempt” organization. Tax-exempt organizations are exempt from most income
U.S. economy and even less aware of the extent nonprofits are subsidized by the government, meaning of course, ultimately themselves as taxpayers. Rather, most taxpayers typically see the economy as consisting of only two sectors – the government sector versus the private sector, the latter being comprised of individuals and for-profit business entities (herein “for-profits”). But, in fact, the nonprofit sector is often referred to as the “third sector” by economists and others precisely because of its significant economic impact. Since charities comprise the largest subgroup of nonprofits and receive the greatest amount of government subsidy, they’re this article’s focus.

I maintain that the relative insipid taxpayer response to charitable waste, compared to other types of government waste, is a product of several overlapping issues
that are so complex they chill taxpayer awareness. So, we don’t just have a problem that needs a solution; we first have an issue that needs exposing as a taxpayer problem. That’s why the latter is the first endeavor of this article and the former is its second.

Accordingly, Part I of this article first elaborates upon the parameters of ILCEE waste that distinguish it from illegal transactions, as well as the other legal transactions described in the first three categories raised in this Introduction. In so doing, Part I highlights the different methods of government-financing involved in the four different exemplar categories as one source of taxpayer confusion, revealing a prime distinction of ILCEE waste – its government financing via what’s called “tax expenditures,” a method not applicable to the other three categories and one far more difficult to calibrate. Next Part I presents statistics emphasizing the economic impact of charities and the reasons we should care about charitable waste. Finally Part I asserts that, contrary to some instincts, the current economic downturn offers excellent timing for addressing charitable waste.

Part II then moves to discussing probable reasons for the lack of taxpayer reaction to charitable waste, analyzing their underpinnings, and projecting that the reasons are so intractable as to warrant a tax solution rather than an unlikely political one. Next, Part III turns to focusing on how ILCEE waste occurs, emphasizing the huge role that “restricted gifts” play in the pervasiveness of ILCEE waste, including discussions of charities most likely to have restricted gifts, review of a seminal restricted gift case - In Re Estate of Buck - and finally, consideration of the difficulties in defining waste. Part IV next discusses potentially applicable current laws that might curb ILCEE waste, principally the doctrines of common-law waste and cy pres, including recent recommended and/or enacted expansion amendments to the cy pres doctrine to cover waste, as well as the most likely current tax-exemption law avenues of redress, such as the “private benefit” doctrine and “intermediate sanctions.” It posits that these laws are inadequate to the task of preventing or curbing ILCEE waste, that this lack of recourse must be corrected, and that the best corrective measure is a tax on ILCEE waste. Finally, Part V examines why the suggested federal tax (rather than a tax-exemption) solution is the most appropriate avenue for ameliorating ILCEE waste and proposes design criterion for such a tax that even addresses the most difficult conundrum of any such solution, i.e., how to define ILCEE waste.

I. PARAMETERS, FINANCING & IMPACT OF ILCEE WASTE

A. The Basic ILCEE Waste Definition

ILCEE waste refers to perfectly legal, lavish consumption by charities. As referenced in the opening of this article, such consumption is called “ILCEE waste” herein with ILCEE serving as an acronym for the first five letters of the following phrase - inappropriate [but] legal charitable excessive/exorbitant expenditure. Tax law scholars, Professors Edward J. McCaffery and John D. Colombo, each addressing more limited and somewhat different topics than this article, use the terms “nonurgent expenditures”
and “failure to conserve,” respectively, to describe sub-categories of ILCEE waste. These other terms, and the context in which they are used by the referenced scholars, are discussed in more detail later. But I believe the term “ILCEE waste” best reflects the full scope of expenditures covered by the contextual framework of this article. In this regard, two features of ILCEE waste are particularly worthy of elaboration at this juncture – that ILCEE waste concerns lawful expenditures and involves a charity payor.

1. The Lawful vs. Illegal Emphasis

ILCEE waste is lawful (rather than illegal) in that it involves situations where the expenditures are subject-matter appropriate for government financing because they relate to government missions or objectives and fall within the authorized operations of the payor charity. In other words, the expenditures primarily serve legitimate governmental and charitable interests, rather than mostly private-party agendas. Generally, as long as government or charitable expenditures are cloaked in subject-matter appropriateness and legitimate charitable authority (herein “thematic target legality”) and don’t unduly crossover into private-agenda territory, or involve fraud or conflicts-of-interest, they’ll typically be lawful even if wasteful. This means, as noted in a recent editorial of a major newspaper, that “[c]urrently, nonprofits—from private schools to hospitals to nursing homes—can pay huge executive compensation and spend millions on new buildings with essentially no repercussions other than outsiders raising their eyebrows.” For example, the wasteful expenditures on the C-17s, the abusive use of bailout grants and the charitable extravagance described in the Introduction were all legal expenditures. This is because there’s nothing per se illegal about the government, charities or other entities being irresponsible spendthrifts.

Despite this lawfulness, ILCEE waste definitely violates the essence, if not the exact border, of its thematic target legality because too much is paid for too little value received. In other words, services or items purchased are either significantly over-priced for what’s provided given market realities and prices, or are appropriately priced for what’s provided but are extremely lavish or frivolous as government expenditures in light of economic realities or governmental priorities. That’s why ILCEE waste is a focus of this article. Increasingly, nonprofit watch-dog groups urge “Congress …to ensure the public is getting its money’s worth from the tax subsidies charities enjoy.”

Lawmakers and the Internal Revenue Service (the IRS) have responded with wide-ranging

36 See infra Parts II.C and V.B, respectively.
37 I.R.C. § 501(c)(3) lists the required targets of activity for tax-exemption. Also see Stamler, supra note 20 and FORBES, Nonprofit Millionaires, supra note 21 discussing the “reasonableness” standard for expenses.
38 Private-party agendas are a principal element that typically distinguishes illegal government and charitable expenses from legal expenditures. See infra Part IV.C, discussing the private benefit, private inurement and excess benefit tax rules. Usually as long as expenditures paid to private parties for goods or services are “reasonable” as measured by free market values (which can be quite high and still be considered reasonable), they’ll be legal and permissible.
40 See infra Part II.C for elaboration of this point.
investigations of ways charities can better serve as good stewards of tax-subsidized dollars. Still, laws targeted at ILCEE waste abuses remain lacking.

In contrast, illegal charitable expenditures are not the focus of this article precisely because, when discovered, they get a lot of public attention and something corrective can be done about them. In fact, illegal expenditures by charities often get more attention than warranted. Because of the so-called “halo” that charities enjoy as mostly do-gooder institutions, donors to charities feel particularly violated when charities abuse donor goodwill and trust and engage in illegal transactions. That’s why scandals involving non-profit illegalities in the last two decades have received such widespread press coverage that the image of the entire nonprofit sector has been sullied. In fact, the recent efforts to increase regulation of all non-profits are a testament to the fact that abusive illegal transactions by an admittedly small number of non-profits may get disproportionate scrutiny relative to the low incidence of illegal transactions in the overall nonprofit sector. Also, unlike ILCEE waste, wasteful illegal expenditures are redressable by legal recourse against the charitable managers guilty of the illegalities. Moreover, the financial and operational viability of most charities depend heavily upon reputation. So a charity’s typical response to the reputational harm done to it by disclosures of illegal management behavior is akin in corrective impact to that resulting from the political pressure and outrage that surrounded the Halliburton and bailout abuses noted in the Introduction.

ILCEE waste is different, going relatively unnoticed by most of the public. Even worse, in many instances, extravagance may even be touted by payor charities as a source of competitive superiority/pride relative to other charities. Consider, for example, recent news reports of private colleges with high tuition building and marketing new “luxury” dorm facilities with maid service, river views and tanning beds to lure students. None of these news accounts even raised the issue of government waste. This is a very telling omission. Further, even when revealed as wasteful, ILCEE waste remains uncorrected because the current tools for redress are sorely inadequate. Fortunately, the mere threat of taxpayer outrage keeps most potential government-financed waste in check. But with

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42 PHILANTHROPY, A Sharpened Eye, supra note 39. For a review of recent reform efforts and laws up through early 2006 see FISMAN & SCHWARZ, supra note 25, at 13-17. In addition, in 2006 Congress enacted the Pension Protection Act of 2006 that includes some of the most significant nonprofit tax legislation in several decades. JAMES J. FISMAN & STEPHEN SCHWARZ, NONPROFIT ORGANIZATIONS, CASES AND MATERIALS (3d ed. 2006) 2009 SUPPLEMENT I(2009)[hereinafter FISMAN & SCHWARZ SUPPLEMENT]. Since that enactment, Senate Finance Committee ranking member Charles Grassley, with the cooperation of committee chair Max Baucus, continues the accountability charge. Id. “Both the House and Senate tax writing committees have expressed interest in the scope of charity and whether §501(c)(3) organizations are providing a sufficient public benefit by conducting charitable programs commensurate in scope with their resources.” Id.

43 See infra Part IV.C.


45 See FISMAN & SCHWARZ, supra note 25, at 11-13 and150-151 (describing some of the big scandals).

46 See MARION R. FREEMONT-SMITH, supra note 27, at 13-15 (discussing a 2003 study that revealed illegal wrongdoing is not as widespread as some claim); FISMAN & SCHWARZ, supra note 25, at 11-13,242-243.

47 See FISMAN & SCHWARZ, supra note 25, at 151, 243.

ILCEE waste such public outrage is so muted, for reasons set forth in Part II, it’s not a likely tool for curbing the incidence of ILCEE waste.

2. The Charity Payor Emphasis – the Different Financing Used

a. The Primary Government Financing Methods and Their Purposes

The methods of financing the various expenditures described in the Introduction are different, due in large part to the varied governmental responsibilities and purposes served by the expenditures. Broadly speaking, the federal government’s lawful thematic target expenditures\(^{49}\) span two overlapping, but separate, spheres – those in service of mandated or authorized governmental operations and functions (herein “mandated functions”) and those in support of broad public policy goals or initiatives considered to foster overall public well-being,\(^{50}\) even though not the rubric of a specific government department or mandated function (herein “public purpose endeavors”). Mandated functions implicate activities that the federal government has primary responsibility (and often the only authority) to perform, like overseeing military needs, keeping track of social security benefits, maintaining national parks, monitoring anti-terrorist security, providing FEMA aid after a natural disaster, etc.\(^{51}\) These and other mandated functions usually result in collective goods or benefits\(^{52}\) that similarly situated members of the public typically can access and benefit from equally, like clean air, federal highways and bridges, national parks and monuments and the like.\(^{53}\)

In contrast, public purpose endeavors span the gamut of matters Congress determines worthy of financial support, even when this support may benefit some private parties substantially more than others similarly situated. In fact, public purpose endeavors often finance specific non-governmental/private-party operations,\(^{54}\) like research and development of “green” technology and other medical and scientific advancements, the encouragement of culture and the arts, Head Start programs for early childhood education, or disaster aid to foreign governments. Unlike the collective benefit arising

\(^{49}\) See supra discussion following note 38.

\(^{50}\) See CRS Overview, supra note 23, at 35-45; FISHMAN & SCHWARZ, supra note 25, at 75-76.

\(^{51}\) All the referenced activities are the responsibility of a Federal department or agency. Military operations are overseen by the U.S. Department of Defense, \url{http://www.defense.gov/admin/about.html}. It is the job of the U.S. Social Security Administration to keep track of social security benefits, \url{http://www.ssa.gov/}. National parks are cared for by the National Park Service, a bureau of the U.S. Department of the Interior, \url{http://www.nps.gov/aboutus/index.htm}. Anti-terrorist oversight is the U.S. Department of Homeland Security’s job, \url{http://www.dhs.gov}. F.E.M.A means the Federal Emergency Management Administration which became part of the Dept. of Homeland Security in 2003, \url{http://www.fema.gov/about/index.shtm}. Also see generally a description of the responsibilities of all thirteen U.S. Departments at \url{http://www.whitehouse.gov/our-government/executive-branch}.


\(^{54}\) For example, the IRS allows “incidental” private benefit under Treas. Reg. §1.501(c)(3)-1(d) (1)(ii). See FISHMAN & SCHWARZ, supra note 25, at 485-486; MARION R. FREMONT-SMITH, supra note 27, at 250-252;
from mandated functions, the inventors or manufacturers of the new technology, the particular children attending the Head Start programs, the artist whose work is exhibited, and the aided foreign citizens benefit more in quantitative degree and quality from these endeavors than do other members of the general public. Again, as an extreme example, consider the bank and auto industry bailouts of 2008-09. Although they were considered by Congress as a necessary emergency measure to stabilize the economy for the ultimate benefit of all, everyone acknowledges that the bailed-out banks and their shareholders benefited more directly and to a hugely greater degree than Joe and Jill Public.  

Several methods are used to fund mandated functions and public purpose endeavors. Obviously, the government primarily uses a non-intermediary process for mandated functions; it hires and pays its own government employees (through its various departments and agencies) to carry out governmental activities. But when the number or expertise of government employees is inadequate to carry out a mandated function and additional hiring is not warranted, or when public purpose endeavors need to be financed, the government utilizes intermediary methods. There are 3 intermediary methods primarily used: 1) contract payments; 2) grants; and 3) tax expenditures. Each is detailed below.

First, regarding contract payments, the federal government contracts with private individuals and entities, both for-profits and nonprofits, that have particular expertise, to shore-up government workforce size or experience shortcomings by performing task-specific government projects (like food service to troops away at war, construction of a new military ship or plane, or a bridge in a foreign country). Typically these contracts are put out for public bid to ensure the government doesn’t pay above-market price for these projects and the contracts are subject to oversight accountability standards requiring the government to monitor and audit contracts. But occasionally these safeguards fail and excessive expenses may result, like with the Halliburton incidents described in the Introduction.

Second, grants, on the other hand, are used for public purpose endeavors, like the operation of a Head Start nursery school program for pre-schoolers. Grants are federal donations or contributions (i.e., free gifts, not in exchange for consideration like the contract payments described above) frequently made to charities, as well as local governments and other types of nonprofits, that agree to undertake the specific endeavors being subsidized by the grant. Public purpose endeavors funded via grant awards are usually subject to reporting obligations by the payee entity to the government to insure


56 This is likely because of a limited project duration or focus not justifying permanent hires.

57 See generally CBS Overview, supra note 23, at 16. The subtleties of other public financing methods, including bond financing or fee financing, are typically hybrids or overlap the three featured methods and thus are not addressed in this article.

58 See generally FEDERAL ACQUISITION REGULATION [hereinafter FAR], the primary regulation for use by all Federal Executive agencies, issued under broad policy guidelines of the Office of Federal Procurement Policy, Office of Management and Budget, https://www.acquisition.gov/far/current/pdf/FAR.pdf. See also POGO, supra note 1, at its Federal Contracting Resources link listing contracting resources, including the FAR, http://www.pogo.org/investigations/contract-oversight/federal-contracting-resources.html.

59 See the Federal government’s definition of a grant at http://www.grants.gov/help/glossary.jsp#b.
that the monies are used as required by the grant guidelines.60 This accountability oversight, coupled with the fact that budgets for grant projects are either prepared or approved by the government in advance based on a given project’s scope,61 and also that grants are typically awarded to multiple-grantees (as opposed to the winner-takes-all focus of the government contracting process), significantly reduces the occurrence of ILCEE waste in the grant-making process, likely even below that applicable in the government contract setting.62

Third and finally, tax expenditures, even though also involving an intermediary process, constitute a wholly different methodology than government contract payments and grants. Contract payments and grants have one key thing in common; they both involve direct payments by the federal government to a contractor or grantee. Tax expenditures involve anything but. In fact, this third method of government financing is so indirect that it’s bewildering to the point of obfuscation.

3. The Definition of a Tax Expenditure

The official definition of tax expenditures is that they are “revenue losses attributable to provisions of the Federal tax laws which allow a special exclusion, exemption, or deduction from gross income or which provide a special credit, a preferential rate of tax, or a deferral of liability.”63 This is certainly vague. A bit more guidance, but not much, is found in the following statement by Professor Stanley Surrey, the person who introduced the phrase “tax expenditure” to U.S. tax policy when he served as Assistant Secretary of the Treasury for Tax policy:64

The term “tax expenditure” has been used to describe those special provisions of the federal income tax system, which represent government expenditures made through that system to achieve various social and economic objectives. These special provisions provide deduction, credits, exclusions, exemptions, deferrals, and preferential rates and serve ends similar in nature to those served by direct government expenditures or loan programs.65

Based on the foregoing, one can understand why the average taxpayer might not comprehend the meaning of tax expenditures, assuming that is, that she has even heard the term. True, there’re certainly some taxpayers, like academics, economists, lawyers, accountants and the like, who’ve studied tax law beyond their own respective need-to-

62 In contrast to the winner-takes-all result in the public bidding competition for government contracts, the competition among typically non-exclusive grantees for public purpose endeavors causes the federal government to parse the money conservatively among as many grantees as feasible.
63 Analytical Perspectives, Budget of the United States Government, Fiscal Year 2010, ch.19, at 297, (February 2010) [hereinafter Analytical Perspectives (2010)], available at www.budget.gov. Analytical Perspectives “presents analyses that highlight specified subject areas or provide other significant data that place the Budget in perspective.” Id., at 3. “The Congressional Budget Act of 1974 (Public Law 93-344) requires that a list of ‘tax expenditures’ be included in the budget.” Id., at 297
64 See Joint Committee on Taxation, A Reconsideration of Tax Expenditure Analysis (JCX-37-08), May 12, 2008, at 2, available at www.house.gov/jct.
know focus, who conceptually understand the term tax expenditure. But even within this narrow sliver of society, the people with clarity about how to determine, let alone calculate, the tax expenditure subsidy is relatively few.

The tax expenditure form of indirect subsidy provided to charities (and substantial others) has similar dollar-for-dollar equivalencies to the contract payments primarily made to for-profit entities and the grant payments primarily made to nonprofits. But lack of calculability arises because, with tax expenditure budgeting, there’s no clear transfer of a fixed amount of $X dollars to a particular charity or even charities as a group. Instead, the collective tax exemptions, charitable deductions and other benefits provided reduce the tax revenues that would otherwise be received and available for other government uses. Still, they are called tax expenditures in federal budget terminology because they are considered part of, and added to the base of, tax revenues (or the lack thereof) deemed “spent” by the government.

These indirect subsidies to charities aren’t obvious or easily discernable because the ordinary taxpayer can’t assess how much subsidy is being provided to each charitable entity without knowing how much tax revenue is being given to one cause, or, sometimes more poignantly, is being lost to another cause that goes wanting. And that how-much-determination of income tax subsidy, in turn, depends on two factors: 1) the net revenues (and thus, the appropriate tax bracket) of each charitable organization that would otherwise pay taxes if it weren’t exempt from income taxation, and 2) the income tax bracket of each taxpayer/donor who gets a charitable deduction for contributions to the charity under scrutiny (or as this article points out, not much scrutiny at all when it comes to the amount of taxpayer subsidy for charities). In an era when transparency is the sine qua non of accountability discourse, particularly that of government, this level of obscurity is problematic. If we at least had some anti-waste incentives, as this article proposes, taxpayer interests would be significantly more protected.

Thus, the circle is revealed. The primary reason this article focuses on lawful (versus illegal) but wasteful spending by charities (rather than government or for-profit entities) is because ILCEE waste is not typically redressable legally. Yet government financing of charities, including ILCEE waste, is sufficiently incomprehensible that it’s highly unlikely to engender political pressure for change brought on by taxpayer outrage. Unlike the first three categories of government waste highlighted in the Introduction, the very fact of, let alone the extent of, government financing of charity extravagances like those described in the fourth category, is so obscured that it’s essentially

66 The total listing of tax expenditures exceeds 160 types. See ANALYTICAL PERSPECTIVES (2010), supra note 63, tbl. 19-1, at 301.
67 However, “estimates … for individual tax expenditures … do not necessarily equal the increase in Federal revenues (or the change in the budget balance) that would result from repealing … [the] provisions, for … [two] reasons. First, eliminating a tax expenditure may have incentive effects that alter economic behavior … affect[ing] the resulting magnitudes of the activity of other tax provisions or Government programs. … Second, tax expenditures are interdependent … [and a] repeal … can increase or decrease the tax revenues associated with other provisions.” See ANALYTICAL PERSPECTIVES (2010), supra note 63, at 298.
68 But see supra note 67 (indicating why a dollar-for-dollar revenue increase correlation may not be exact).
69 They’re “spent” in the sense that they’re revenues not taken in, which (subject to the comments supra in note 67) might otherwise be available for worthy government projects or direct expenditures.
70 I.R.C. §501(a) provides the exemption from taxation for nonprofits.
71 I.R.C. §170 provides income tax deductions to donors for their contributions to tax-exempt charities.
72 See infra Part V.
incomprehensible to an average taxpayer, or to anyone who isn’t an economist or a high-
level math sophisticate. This is a key reason taxpayer response to ILCEE waste is
significantly less than that engendered by other types of government waste. Still, as
revealed in Part III, this isn’t the sole reason.

But before examining all the possible reasons for the relative lack of taxpayer
response, let’s examine why we should care about it.


So far this article has defined the parameters of ILCEE waste, questioned the
reduced taxpayer response to this type of waste relative to other types of government
waste, and determined the financing methodology of charities, particularly the tax
expenditure method. The next issue warranting attention is whether ILCEE waste is
significant relative to the universe of government waste problems and other problems.
Let’s face it, if ILCEE waste rarely occurs, or only involves an infinitesimal monetary
issue, why bother to consider it or read this article, particularly at this time of economic
downturn for all, including charities? This section illuminates that ILCEE waste is very
significant both quantitatively and qualitatively, particularly in this time of economic
stress.

First, it’s important to recognize that there are 1.4 million organizations that
comprise the nonprofit sector (over 1 million of which are charities) and they hold
assets exceeding $2 trillion and receive charitable contributions from individuals,
corporations and foundations estimated at $241 billion annually. Moreover, the 200
largest public charities (i.e., not including private foundations, which are the wealthiest of
charities) had $605 million of revenue in 2009 and all charities received over $300
billion in donations in 2008. These figures alone indicate that there’s considerable room
for potential ILCEE waste. “Despite the proliferation of revenue-generating activities by
nonprofits, the public perception of [them] is still dominated by images of break-even
balance sheets and under-paid, altruistic staff assisted by martyr-like volunteers.”
Although these images are still accurate for many nonprofits, news reports of excessive
expenditures by nonprofits indicate that there’re a significant number of very wealthy
charities that are wasteful. When this fact is coupled with knowledge of the size of the tax
benefits charities receive, as described below, it’s clear ILCEE waste warrants attention.

1. Direct and Incidental Charitable Payments and Benefits

Government subsidies and benefits provided to charities take many different
forms, as particularly well-detailed by Professor Evelyn Brody in a 1999 article exploring
the possible impact of tax reform on charitable subsidies. But for purposes of this

74 MARION R. FREMONT SMITH, supra note 27, at 1. See also William P. Barrett, Special Report, America’s
giving-gates-foundation-personal-finance-charity-09-intro.html (discussing charitable revenues at the
largest public charities (i.e., not including private foundations, which hold significant assets)).
75 Barrett, supra note 74.
76 Stephanie Strom, supra note 73.
77 Lewis, supra note 25, at 1771.
78 Id.
79 Brody Subsidies, supra note 27, at 697-698 (containing a descriptive listing of the tax benefits provided).
article, it’s sufficient to examine only the major categories of these subsidies and benefits.

First, as previously stated, charities, like other nonprofits and for-profits, receive direct payments from the government either as grants or fees for service or transfers. For 2005, the Congressional Research Service (CRS) estimated that direct payments to charities amounted to about $351 billion and accounted for 29% of charitable organizations’ total revenue that year.\(^8^0\) This is a very significant percentage, indicating that charities heavily rely on direct governmental expenditures. In fact, as noted by Professor Evelyn Brody, “[t]o a large degree, most of the . . . explosive growth in the nonprofit sector can be attributed to the ‘outsourcing’ of federal social service spending through the nonprofit sector, either by contracting for services or by funding fees paid by clients, such as through Medicare.”\(^8^1\)

In addition to direct payments, charities also typically enjoy a number of incidental federal, state or local tax and/or societal benefits, including preferred postal rates,\(^8^2\) tax-exempt bond financing privileges,\(^8^3\) exemption form state and local government sales taxes and property taxes,\(^8^4\) and protection from involuntary bankruptcy petitions.\(^8^5\)

These direct payments and incidental benefits are highlighted here to provide a total context for appreciating the full extent of governmental support of charities. But since these direct payments and incidental benefits typically involve some form of anti-waste safeguards either via contract, as previously noted\(^8^6\) or because of the inherent nature of the benefit, they are not typically likely funding sources for ILCEE waste. But the third category of charitable government subsidy and benefits - tax expenditures - is a potential source because of the reduced accountability attributable to its indirectness in application.

2. **Broad Perspective on the Two Primary Subsidies (via Tax Expenditures)**

The primary Federal tax expenditure categories that benefit charities are two: 1) deductibility\(^8^7\) and 2) exemption.\(^8^8\) The deductibility benefit allows every taxpayer who makes a contribution to a charity an annual deduction against her own income tax liability for a given year, or in the case of a deceased taxpayer, against her estate tax liability for the year of her death.\(^8^9\) The exemption benefit provides exemption from income tax by a charity on its gift contributions, sales and fee-for-service earnings, and investment earnings. This tax expenditure benefit is also provided not only to charities,

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\(^{80}\) See CRS Overview, *supra* note 23, fig.4 at 17 and discussion at 28.

\(^{81}\) Brody *Subsidies*, *supra* note 27, at 696.

\(^{82}\) CRS Overview, *supra* note 23, at 38.

\(^{83}\) I.R.C. §145. “Purchasers of bonds issued by [charities]… do not have to pay tax on interest from such bonds.” Anup Malani & Eric A. Posner, *The Case for For-Profit Charities*, 93 VA. L. REV. 2017, 2026.

\(^{84}\) See FISHMAN & SCHWARZ, *supra* note 25, at 470-475.


\(^{86}\) See *supra* discussion between notes 57-59.

\(^{87}\) The deductibility benefit is authorized per I.R.C. § 170 for income taxes, per I.R.C. §2055 (a) (2) estate taxes and per I.R.C. §2522 for gift taxes. See generally Brody *Subsidies*, *supra* note 27, at 699-700.

\(^{88}\) Exemption is authorized per I.R.C. §§501. See generally Brody *Subsidies*, *supra* note 27, at 699-700.

\(^{89}\) See *supra* note 81.
but also most other nonprofits. But unlike other nonprofits, those that qualify as charities are the only ones that get the unique, and highly financially meaningful, deductibility benefit. The following offers some quantitative and qualitative perspective on the two broad categories of deductibility and exemption tax expenditures.

\[ a. \quad \text{The Quantitative Perspective} \]

As a start, consideration of the absolute dollar significance of a subsidy is always helpful in determining and focusing priorities in a capitalistic society. “The most widely estimated and discussed [tax benefit provided charities] is the deduction for charitable contributions, estimated in FY2008 to reduce federal revenue by about $46 billion.” Fortunately, the value of tax expenditures attributable to the deductibility benefit is quantified annually by the Joint Committee on Taxation. So an industrious taxpayer can find out the high value of the charitable sector subsidy, even if a charity-by-charity (or even charity group) break down is not available. In 2000, the cost estimate was $25.85 billion for income tax deductions, plus another $6 billion for gift and estate tax deductions, for a total of $31.85 billion that year. In just 9 years that figure grew significantly. So by 2009 the value of the income tax deduction was estimated at $50 billion and the estate tax deduction at $4.3 billion for a total value of $54.3 billion in deductibility type tax expenditures for 2009. Moreover, in projecting out for the four year period of 2009-2013, the increase from 2000 is estimated at an extraordinary 200.6% to reach a 2009-2013 projection of the value of just the charitable income tax deduction (i.e., exclusive of the less quantifiable income tax exemption) of $335.45 billion in tax dollars or tax expenditures paid to the charities over this 4 year period, or roughly $83.9 billion per year in the next 4 years.

Less visible, but equally, if not more, important for wealthy charities, the tax exemption benefit allows organizations to accumulate assets without paying tax on earnings. While this benefit is difficult to estimate, the estimates that do exist indicate that the revenue loss from the exemption tax benefit is even larger than that associated

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90 There over 30 classifications of tax-exempt organizations under I.R.C. §501, of which 27 are described under I.R.C. § 501(c). But only those described in § 501(c) (3) qualify for preferred status as charities. See FISHMAN & SCHWARZ, supra note 25, at 62, 323-324.
91 I.R.C. § 501(c) (3) details the qualification requirements for charities entitled to the deductibility benefit.
94 Brody Subsidies, supra note27, at 695. “The tax expenditure budget treats the income-tax exception as part of the normal tax base.” Id., at note 18 “In addition, because individuals can deduct their charitable contributions only if they itemize and fewer than 30% do so, a portion of the standard deduction should count, too. If the standard deduction were set too low, generous taxpayers would itemize instead. [citations eliminated].” Id.
95 Id.
96 See CRS Overview, supra note, at 23, at 43
97 ANALYTICAL PERSPECTIVES (2010), supra note 63, at tbl.19-3
98 CRS Tax Issues, supra note 89, at CRS-3. “The unrelated business income tax, or UBIT, is imposed on business activities unrelated to the charitable purpose, but it does not apply to investment earnings such as dividends and interest.” Id., note 2.
with the deductibility benefit.\textsuperscript{99} Moreover, [f]or universities and colleges, [who typically hold large charitable endowments] these benefits are several times as large as the savings by donors from deducting charitable contributions.\textsuperscript{100}

Unfortunately, there’s no official data on the value of the exemption of charities from taxation. Moreover, unofficial estimates of the value of charities’ federal income tax exemptions are very limited and are of recent advent.\textsuperscript{101} The reason: the Joint Committee on Taxation doesn’t consider the lack of tax on earnings as a tax expenditure so it doesn’t provide estimates of the cost of this provision.\textsuperscript{102} This is a highly curious position\textsuperscript{103} given that the official definition of tax expenditure\textsuperscript{104} includes as one of its first matters “exemptions” from federal income tax. So this position doesn’t correlate with the official definition of a tax expenditure. Given this fact, there’s really no excuse for this omission and the concomitant lack of transparency it generates.

Fortunately, non-official estimates of at least the largest part of the possible exemption value do exist now. In late 2009, CRS reported that based on Form 990 IRS filings\textsuperscript{105} by nonprofits in 2006 of most of their income, primarily of the investment type – i.e., “net rent, dividends, interest, and capital gains on securities,”\textsuperscript{106} there was at least $170 billion of nonprofit income for fiscal year 2006 that was exempt from taxation. Assuming a 35% tax rate, there was a revenue loss in 2006, solely from the exemption component of the tax expenditure subsidy, of $60 billion.\textsuperscript{107} This is $60 billion from just a part of the exemption benefit. That’s certainly no small amount.

So the combined tax expenditure subsidy from both the deductibility benefit ($83.9 billion) and the exemption benefit ($60 billion) is approximately an impressive $143.9 billion annually. When these sums are increased by federal grant payments (about $90 billion) and state and local tax subsidies (estimated to be approximately $30-$50 billion), the total amount of governmental subsidies approximates to $245 billion to $280 billion!\textsuperscript{108}

\textsuperscript{99} “If charitable contributions were spent quickly, this benefit would be minimal. If contributions are held as assets and invested, tax exemption may confer significant benefits. There are several ways in which donations are invested rather than spent. Some types of active tax-exempt organizations maintain assets in the form of endowments, particularly educational institutions. Private foundations are often originally funded with a large donation and pay out a small share of assets (required to be at least 5%, however). Two other types of institutions are similar to private foundations in that they do not directly engage in activities and accumulate assets from which they make payments: supporting organizations and donor-advised funds. CRS Tax Issues, supra note 89, at CRS-3.
\textsuperscript{100} Id., at CRS-2. “If university endowment earnings alone were subject to the corporate tax, the revenue gain is roughly estimated at over $25 billion per year for FY2007 (which ended, for most of these institutions, in June 2007). It is more than three times as large as the revenue loss for charitable donations to all educational institutions, which total around $7 billion.” Id.
\textsuperscript{101} See Brody Subsidies, supra note 27, at note 17 and accompanying text.
\textsuperscript{102} CRS Overview, supra note 23, at 41-42.
\textsuperscript{103} See FISHMAN & SCHWARZ, supra note 25, at 331(recounting the stated reason and that some disagree).
\textsuperscript{104} See supra note 63 and accompanying text.
\textsuperscript{105} This is the annual information return for nonprofits. Marion R. Fremont Smith, supra note 27, at 65-66.
\textsuperscript{106} CRS Overview, supra note 23, at 42
\textsuperscript{107} Id. It should be noted that CRS Tax Issues, supra note 89, at CRS 1-3, using older data and somewhat different numbers posits an estimate of a total of $100 billion for both the deductibility and the exemption benefit, with each accounting for about half. This is still quite a significant number.
\textsuperscript{108} CRS Overview, supra note 23, at 38
The foregoing makes it crystal clear that as a quantitative matter the governmental tax subsidy to charities as a group is substantial in both absolute terms as well as relative terms. In fact, tax expenditures for only the deductibility benefit (i.e., exclusive of the exemption benefit) rank third among all the tax expenditure categories for the 2010-2014 budget. Given governmental priorities this is impressive. The next question is why. The answer shifts the focus from the quantitative to qualitative.

b. The Qualitative Perspective

For advocates of a pluralistic society who support a myriad of causes and interests, the foregoing quantitative perspective, illuminating the enormity of the charitable government subsidy, is something many in this country would consider a matter of national pride. This is because of two related, but independent reasons – one normative and the other expressive: a) the normative function of charities as a force for public good; and b) the expressive (and hopefully aspirational) function of charities as part of a representative democracy’s means of communication and full participation.

First, we must place ILCEE waste in context with private and governmental waste generally. In this regard, it’s appropriate to acknowledge that there’s a lot of waste everywhere and society tolerates some level of it as a basic fact. We have to prioritize our concerns. Thus, wasteful spending by private companies for their respective agendas, even when they get business tax deductions for some of these wasteful expenditures, is typically viewed as a problem for shareholders and owners of those companies, rather than as a taxpayer problem. Until Jill Public is asked to bailout a private company in her capacity as a taxpayer, she’s ordinarily not concerned that Ford executives use private jets to attend meetings unless she’s a shareholder of Ford.

But when the U.S. government contracts with and pays private companies to perform mandated governmental functions (like providing extra troops in a war or building a domestic freeway), any government inefficiency or poor monitoring of the carrying out of these governmental functions by private companies attracts attention and is fodder for criticism. Even more outrageous is when the government subsidizes the private, capitalist endeavors of for-profit companies such as with the 2008-2009 bank and automobile industry bail-outs. This is when taxpayer anger really explodes. And so it should. Such bailouts primarily, versus tangentially, involve taxpayer subsidy of the agenda of private sector businesses, or to put it another way, subsidy of someone else’s profit, not in pursuit of particular government functions or agendas.

So where do the wasteful expenditures of charities fall in the spectrum of governmental versus private waste? The answer to this question reveals why the

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109 See ANALYTICAL PERSPECTIVES (2010), supra note 63, tbl. 19-3 at 308. The tax expenditure for just the non-education and non-health charities ranks 4th and with the other groups added the ranking is 3rd place.
111 See I.R.C. §162 (governing the deductibility of “reasonable compensation” by for-profits).
112 Private sector waste also costs but it’s assumed that competition and the private markets will eventually correct the over-spending in favor of profitability. These factors have limited applicability to nonprofits.
113 For example, for-profit tax deductions for excessive salaries are more tangential. Knauer, supra note 27, at 108.
government subsidizes the nonprofit sector to such a significant extent and thus, the context for evaluating ILCEE waste.

Unlike regular government payments to government contractors that support mandated functions, or highly unusual bailouts of for-profit entities, supporting private agendas because of emergency situations that have broad public repercussions, charitable subsidies support not-for-profit missions. In this regard, a key justification consistently offered for governmental subsidy of charities is that they provide significant public benefits that lighten the burdens of government. In other words, except for missions undertaken by charities, it’s argued that there’d have to be more government expenditure of funds to deal with the problems charities address. For example, if we didn’t have charities trying to find a cure for breast cancer, or helping to feed the homeless, or providing clothing to victims of natural disasters, government would have to spend more on these matters. So it’s reasoned that it’s only appropriate that at least some government subsidy be given. As stated in the 1972 case of McGlotten v. Connally, which relies on even earlier cases, including a 1924 Supreme Court case, and which cites legislative history:

The rationale for allowing [tax-exemption] has been that … the Government relieves itself of the burden of meeting public needs which in the absence of charitable activity would fall on the shoulders of Government. The Government is compensated for its loss of revenue by its relief from financial burdens which would otherwise have to be met by appropriations from public funds. H. Rep. No. 1860. 75th Cong. 3d Sess. 19 (1938). So the public benefit rationale has a long history in charitable tax subsidy jurisprudence. In addition, there’re some things government cannot do, like participate in religious activity, and others it will not do, like act as a check or balance on itself. So these areas are left, respectively, to religious organizations and to public interest groups such as Common Cause.

A related, but independent, second justification for the charitable government subsidy is that it provides significant outlet for expression of the priorities and passions of

114 See generally, Knauer, supra note 27, at 997-998; Fishman & Schwarz, supra note 25, at 45 (quoting another authority); Cafardi & Cherry, supra note 107, at §5.02.
115 This assumes that a majority would vote to see monies expended for these purposes. But charities aren’t reliant on the support of a majority of voters. They only need support of their donors. 338 F. Supp. 448 (D.D.C. 1972)
116 Trinidad v. Sagrada Orden, 263 U.S. 578 (1924), where the court states, “[T]he exemption is made in recognition of the benefit which the public derives from the corporate activities of the class name, and is intended to aid them when not conducted for private gain.” Id. at 581
118 For example, in the early “history of the United States, because the frontier extended beyond the area the country where there was an effective government [...]for their protection and common good, the settlers formed voluntary, nonprofit associations that provided services such as fire protection and security from attack. Volunteer fire companies that exist in much of America today are a prime example of nonprofit organizations that have, historically, always been nonprofit.” Cafardi & Cherry, supra note 107, at 9-10.
the U.S. citizenry. After all, even given tax expenditure financing, if sufficient members of the public don’t support a charitable entity via their charitable contributions, the charity likely will have inadequate funding for its purposes and will eventually fail.\textsuperscript{121} This acknowledges another key point - that governmental priorities are a function of the “median voter.”\textsuperscript{122} In other words, government usually directly funds agendas of the average or median preference voter, even when there may be numerous other agendas that are worthy of some kind of advocacy. So, if it weren’t for charities, what would happen in the margin between median voter support and significant issues that have not sufficiently matured to engender general voter concern? What of public innovation, possibility, and creative thoughts that have not yet (or may never) rise to the level of embrace by the median voter?

When the federal government, via use of deductibility and exemption tax expenditure funding, gives a “leg up” to fledgling efforts of like-minded constituents, it allows marginalized voters who have minority perspectives or priorities to support their perspectives and priorities publicly in a manner that may allow these ideas over time to gain currency and majority support.\textsuperscript{123} This is what happened with environmental recycling and children’s educational television programming, both movements begun with few true believers and original supporters that are today fully accepted.

Nonprofit charitable organizations are a way for every member of our democracy to support the causes they think most important, even if general support for those causes, at a given point in time, don’t garner a sufficient majority-vote following to be undertaken as government projects or priorities. Nonprofits provide the means by which different and possibly shifting points of view, can be voiced and even given needed nuance, complexity and variety, as well as authority, other than through the narrow and fixed lens of winner-takes-all election-day results or periodic dichotomous polling. Accordingly, “[t]he nonprofit sector is . . . a force for democracy.”\textsuperscript{124} It promotes a diversity of views and support, complementing government efforts in some areas and filling gaps in others. “Nonprofits play a crucial role in promoting the values of freedom and pluralism, by encouraging individual initiative for the public good. . . . Nonprofits are also manifestations of community[,] . . . [t]hey mediate between the bureaucratic institutions of government and the individual.”\textsuperscript{125}

Thus, the uniqueness and special missions of individual charities are truly to be celebrated and preserved from a societal perspective. As observed by Alexis de

\textsuperscript{121} See, e.g., Schizer, supra note 53, at 232. An exception would be if the charity were supported by a very small group or one person, making it, in all likelihood, a subcategory of charities called a “private foundation.” See infra Part III.D.3.

\textsuperscript{122} Burton A. Weisbrod, Toward a Theory of the Voluntary Nonprofit Sector in a Three Sector Economy, in the \textsc{Economics of Nonprofit Institutions}, 21, 23 (Susan Rose-Ackerman ed. 1986). See also Lewis, supra note 25, at 1791, and authorities cited therein.

\textsuperscript{123} See Weisbrod, supra note 122, at 30-31; Cafardi & Cherry, supra note 107, at 10. This issue is closely related to the government’s ability to respond. “[Nonprofit] organizations, precisely because they are nongovernmental and need not be attuned to a broad and diverse constituency, can take chances and experiment in areas where legislators and governmental agencies are hesitant to tread.” \textit{Giving in America}, supra note 117.

\textsuperscript{124} Fishman & Schwarz, supra note 25, at 55.

\textsuperscript{125} Id.
Tocqueville, non profits foster the expression of diverse viewpoints, helping to create the vibrant political discourse necessary in a free society and were it not for our charities, America wouldn’t be the democracy it is.

c. Correlating the Two Perspectives

The public benefit and pluralism justifications just noted provide the qualitative perspective needed to understand and balance the enormity of the quantitative perspective of the subsidy noted earlier. These qualitative matters explain why there might be somewhat greater public tolerance for wastefulness among charities than that engendered by excessive expenditures by bailed-out for-profits. But this still doesn’t fully explain why there shouldn’t be taxpayer outrage over excessive expenditures by charities at least equivalent to that engendered by wasteful expenditures by government in the performance of mandated governmental functions. After all, both come under the rubric of “government waste” (as distinguished from for-profit-entity waste after a government bail-out). But as discussed later, in Part II, taxpayers may not view things this way.

Currently, the basic limit on governmental funding of charities is that they commit their missions and operations to legitimate charitable/public purposes. This concept, in turn, is captured in the requirement that a charity must be engaged in one of ten listed missions under the I.R.C. to receive the tax benefits allowed charities. There’s little questioning of the amount of the charitable expenditure if the expenditure has this thematic target legitimacy and it’s funded by tax expenditure budgeting, rather than express grant funding. As previously noted, amount accountability and monitoring are generally inherent in grant payments and incidental benefits to charities, but not necessarily tax expenditure subsidies. Shouldn’t a restraint on the amounts, and not just thematic target legitimacy, also be in place with tax expenditure financing? I think so. But before discussing my proposed tax to do this, another matter first deserves airing. Is this a time for concern about ILCEE waste at all, given current, depressed economic realities, including those of charities?

An aristocratic Frenchman who came to the U.S. in 1831 -- when he was only 25 years old -- and later wrote the widely-published and discussed Democracy in America, a two-volume study of the American people and their political institutions. The book is frequently quoted. See ALEXIS DE TOCQUEVILLE, DEMOCRACY IN AMERICA (J.P. Mayer, ed. and George Lawrence, trans. 1969)

Id. See also CAFARDI & CHERRY, supra note 107, at 54; Barbara Bucholtz, Reflections on the Role of Nonprofit Associations in a Representative Democracy, 7 CORNELL J. L. & PUB. POL’Y 555, 571-583 (1998); James Douglas, Why Charity? The Case for a Third Sector (1983).

See supra Part I.B.2.a.


See §501(c) (3) (listing the purposes as religious, charitable, scientific, testing for public safety, literacy, educational, fostering national amateur sports competition, fostering international amateur sports competition, prevention of cruelty to children, and prevention of cruelty to animals). See CAFARDI & CHERRY, supra note 107, at 7. Moreover, the “charitable” category has broad meaning, including lessening the burdens of government. Id., at 179-184.

Exceptions involve situations of illegality, such as breaches of fiduciary duty or violation of specific tax rules (like the private inurement and private benefit rules), which as previously stated is not the focus of this article. See supra Part I.A.1.

See supra discussion between notes 58-62 (regarding grant payments) and Part I.B.1 (regarding incidental benefits).
3. The Worst of Times as the Best to Deal with Waste

Should taxpayers concern themselves with excessive expenditures by charities in these negative economic times that also have hit the charitable sector extremely hard,\textsuperscript{133} thus undermining the sector’s ability to make excessive expenditures? Absolutely yes. These are the best and most appropriate times to examine the problem of ILCEEx waste by charities. True, conspicuous consumption by charities is unlikely to be as rampant in times like these when charities report record decreases in charitable assets and charitable giving.\textsuperscript{134} But the reality is that there’re still a sizeable number of charities with significant assets and donation support.\textsuperscript{135} For example, despite the downturn in the economy and the fact that many nonprofit leaders took pay cuts, “the median salary for nonprofit leaders [actually] rose 7 percent [during 2008-2009], almost double the rate of inflation.”\textsuperscript{136} Also, history reveals that the concept of wastefulness is most at issue in times of economic hardship.\textsuperscript{137}

Society seems more focused on discerning matters of necessity from matters of luxury in those times when economic priorities must be fiercely examined, if not rationed. For example, during World War II we rationed nylon stockings as a luxury and meat as a reasonable periodic expenditure.\textsuperscript{138} Similarly, in the months and years preceding the 2008 economic meltdown/depression/recession,\textsuperscript{139} few citizens complained of the lavish salaries and bonuses paid to executives of for-profit. But in the face of the economic meltdown and the prospect of government expenditure to prop-up suffering for-profit entities, taxpayers and Congress focused hard on absolute necessities vs. reasonable periodic expenditures vs. unreasonable “luxury” expenditures. It’s almost a given that when government deficits are high and its resources low, it is easy to recognize the low-need situation, and even easier to identify and prohibit the excessive. What might be considered extremely wasteful today could be considered par-for-the-course in better economic times.

In other words, when everyone is feeling comfortable economically, fewer taxpayers care about government waste, or waste of any kind. In fact, in good economic times what might be seen by some as wasteful/excessive expenditure is typically seen by many as another ordinary taxpayer’s hard-earned largesse. In essence, enjoyment of an amorphous notion of excess is seen as a part of the American dream that every taxpayer can potentially obtain.\textsuperscript{140} But when more taxpayers believe themselves shut-out from, and


\textsuperscript{134} Id.

\textsuperscript{135} See supra notes 73-78 and accompanying text.

\textsuperscript{136} Barton & Gose, supra note 132.

\textsuperscript{137} For example, consider the contrast in October, 2009 over the $30,000 per couple dinner charge for guests at a fundraiser attended by President Obama. In better times the cost wouldn’t have been a focus of the news stories. See, e.g., \textit{Obama Fundraiser Raises Eyebrows}, NBC Nightly News, Oct. 19, 2009.


\textsuperscript{139} See supra note 11.

even worst, paying for, others’ dreams of excess, particularly exorbitant excess or conspicuous consumption, they become absolutely furious. Previously amorphous waste becomes specifically targeted and identified. This is why the lack of transparency about government subsidy of charities is extremely important. It dampens and thwarts normal taxpayer reaction to government accountability during bad economic times, as well as good ones because wastefulness is a difficult concept to agree upon.\textsuperscript{141}

The foregoing comments presage the next area of focus - the likely underlying reasons why ILCEE waste doesn’t engender the same taxpayer anger as at least that engendered by waste incurred when government is engaged in a mandated function.

II. THE RELATIVELY INSIPID TAXPAYER RESPONSE TO CHARITABLE LAVISHNESS

I posit that the relative lack of outrage about ILCEE waste can be attributable to three related factors – 1) the lack of transparency of the tax expenditure financing method, 2) the partial nature of the governmental subsidy, and 3) the inherent difficulty of defining waste.

A. Implications from the Lack of Transparency

Lack of transparency inherent in the tax expenditure financing of charities is the starting reason (from which all other reasons emanate) for the reduced taxpayer angst over ILCEE waste. Not a lot of elaboration is needed on this point since it’s been addressed expressly and impliedly before in this article.\textsuperscript{142} Essentially, I assert that the tax expenditure method so obscures the quantitative impact of the government subsidy that taxpayers are lulled into non-recognition and non-acknowledgement of the scope of government support. As previously noted,\textsuperscript{143} every taxpayer can understand a direct grant because it involves a flat, fixed sum of money. It is a dollar-for-dollar exchange of tax revenues that are going to a particular issue or problem, and concomitantly, revenues that are not therefore available for another worthy issue or problem, or, to reduce the tax burden. Direct grants are concrete and objectively quantifiable by everyone.

Accordingly, if the exact same dollar amounts as provided indirectly were instead provided by direct grants traceable to specific charities, taxpayer anger/accountability over instances of ILCEE waste likely would be significantly higher. Taxpayers would be able to see and understand that $X billions were granted to charities and that Charities A, J and Z received $Y millions of these funds. If Charities A, J, and Z (from the universe of Charities A-Z) chose to use those funds on exorbitant expenditures amounting to ILCEE waste (even though not amounting to illegal expenditures) the press, and then the public, would likely “have at them” because the exorbitant use of the grants would be easy to discern. But with tax expenditure financing, the amount of tax dollars given to a particular charity, and to charities in general,\textsuperscript{144} is obscured to the point of being unrecoverable and unknowable. This means that normal political forces against abuse and waste won’t and can’t operate because there’s no knowledge of the quantitative abuse. This lack of transparency, in turn, leads to a lack of knowledge that feeds other

\textsuperscript{141} See infra Parts II.C. and IV.B.2. (discussing the difficulty of defining waste).
\textsuperscript{142} See supra Part I.A. 3.
\textsuperscript{143} See supra discussion accompanying notes 66-68.
\textsuperscript{144} See supra Part I. A. 3.
confusions about the nature of the charitable subsidy. The most significant of these other, related confusions is the public/private duality of the subsidy, next discussed.

B. The Public/Private Duality of Charity Financing

I believe another reason taxpayers respond insipidly to ILCEE waste is that charities are only partially government financed. Pointedly, a significant amount of the financing of charities is private, coming from individuals and for-profit entities in their private capacities. The deductibility benefit (as opposed to the exemption benefit) is a tax expenditure subsidy that can be likened to a matching contribution type subsidy because it comes in the form of a tax deduction for the donor that reduces her taxes.\(^\text{145}\) Given differences in the marginal tax rates of donors, the price for a government match (i.e., the deductibility benefit) to a particular donor varies. So, if “a donor whose income is marginally taxed at 35 percent contributes $100 to a charity, …the donor, by deducting the contribution in computing…her taxable income, saves $35 in taxes …[and] the balance of the contribution, $65, [which] would not have been paid to the IRS, …is clearly ‘private money.’”\(^\text{146}\) Thus, a significant amount of the deductibility subsidy\(^\text{147}\) is private rather than public. And by “giving their own money, donors can direct tax revenue to their preferred cause as well.”\(^\text{148}\) This means that, for accuracy, every giver should view and assess a charity’s actions and expenditures from two perspectives – from the perspective of a taxpayer and again from the perspective of a consumer.

Unfortunately, it appears that donors see their relationship to charities as almost exclusively that of consumers than as supporting taxpayers. For example, when a donor contributes to Charity A homeless shelter or Charity B disaster-relief organization, she’s essentially purchasing its good works – the goods and services it provides to the public – for the benefit of another or the community as a whole. In other words, each charity’s mission product is viewed as a consumer product. In this regard, a donor cares whether her private dollars are being used efficiently and wisely and that she’s not paying for a lemon. Also, because donors likely see charitable waste as a consumer issue, each donor is typically only focused on the charities she supports as a consumer, and not the broader universe of charities she also supports as a taxpayer. As consumers, donors want laws comparable to consumer protection laws that punish consumer fraud and prevent the proliferation of poor quality charitable products. But expenses that a non-donor-taxpayer might view as ILCEE waste by Charity A, might well be viewed by a donor-consumer of Charity A’s product as exactly what she wants delivered or provided to the public.

The combined private/public nature of the financing of nonprofits means that charities reflect and service both private and public priorities – the private priorities of donors as individuals (mostly the wealthy)\(^\text{149}\) and the public priorities of average taxpayers as the ultimate funders of government. So each person and legal entity should

\(^{145}\) Schizer, supra note 53, at 232.

\(^{146}\) Brody & Tyler, supra note 129, at 56.

\(^{147}\) A similar argument can be made (though less forcefully) that the exemption benefit for nonprofits is also partially private money. See Brody & Tyler, supra note 129, at 56. Since the exemption benefit isn’t as relevant to taxpayer perception as is the deductibility benefit, this point is not addressed here.

\(^{148}\) Schizer, supra note 53, at 232

\(^{149}\) “Wealthy donors have more money to give, and thus can disproportionately influence the allocation of public money (that is, the tax subsidy).” Schizer, supra note 53, at 247.
assess the appropriateness of a charity’s expenditures from two different perspectives - as a consumer and a taxpayer. This duality of perspective, in turn, fuels a lack of consensus about private and public values. An individual may view a given personal expenditure as totally acceptable and appropriate as a matter of her private consumption choices based on her economic situation and lifestyle preferences. But that same individual might view the same expenditure by government as a totally inappropriate extravagance of her taxpayer dollars. This clash of values becomes even more likely in the charitable context because personal preferences about the use of private dollars are necessarily intertwined with the calculus of developing a collective taxpayer consensus about what’s wasteful.

C. The Additional Complication of Defining ILCEE Waste

Simply put, generally ILCEE waste occurs when expenditures exceed the benefit received, in terms of either market value of the benefit or of absolute value of the benefit relative to objective or mission.\(^\text{150}\) Society perceives it as wasteful to pay “too much” (as measured against competitive market rates) for something, or to pay “anything” for things frivolous, \textit{i.e.}, something that has very marginal, or even no, utility to achievement of a particular goal. Stated differently, waste is the intersection of too little received for too much.\(^\text{151}\) This is generally what Professor Edward McCaffery calls a “nonurgent expenditure”\(^\text{152}\) or “nonurgent, frivolous, or excessive consumption – poor choices of how to spend time or value.”\(^\text{153}\) But who determines when something is too much or too little? This is one essential component of the problem of dealing with ILCEE waste.

In the charitable context, the “too little of something” probably means too little public/community benefit is received for too much taxpayer subsidy in the form of tax exemption and tax deductions. But any bottom-line quantitative measure of too-little-for-too-much is inherently elusive. This is because public/community benefit is itself a difficult calculus of the mix of a sufficiently large charitable class of beneficiaries, receiving quantifiable services and benefits, plus the impossible-to-value benefits of pluralism, democracy, innovation, \textit{etc}. which are the non-quantifiable by-products of the non-profit sector.\(^\text{154}\) Whether a particular expenditure on an item or project amounts to

\(^{150}\) The problem of excessive, exorbitant expenditures arises in two situations: 1) when there is too little benefit received relative to the amount of consideration paid for an item and/or service; or 2) when money is paid that many or most would see as frivolous or at least unnecessary to furtherance of the objective, even if the value of the items or services are equivalent to the payment.

\(^{151}\) In this regard, ILCEE waste is different from waste attributable to intentional destruction or nonuse as discussed \textit{infra} Part IV.A.1.

\(^{152}\) Edward J. McCaffery, \textit{Must We Have the Right to Waste?} in \textit{NEW ESSAYS IN THE LEGAL AND POLITICAL THEORY OF PROPERTY} 76, 87 (Stephen R. Munzer ed., 2001) [hereinafter McCaffery, \textit{Waste}].

\(^{153}\) \textit{Id}. at 86

\(^{154}\) See, \textit{e.g.}, Brody & Tyler, \textit{supra} note 129, at 57 (noting this as the reason a simple \textit{quid pro quo} approach is faulty). As noted by the Deputy Director of Charity Navigator in a 2002 article, “[I]t’s inherently difficult to place a value on such services as feeding the hungry, healing the sick, or educating the underserved. As a result the charity world simply lacks those easy-to-communicate, uniform bottom-line numbers that serve as barometers and guides in other areas of our lives, numbers such as quarterly earnings or win-loss records or even report cards. The bottom-line for a food bank may be how many meals it serves, while that same bottom-line says very little about a medical research institute. Although surveys show that givers want more data on charities, we have been willing to overlook the lack of a bottom-line and have continued to support worthy causes.” Kyle Waide, \textit{Evaluating Charities: Why the Numbers Count}, 2002, \url{http://www.charitynavigator.org/index.cfm?bay=content.view&cpid=65&print=1}.
wastefulness, *i.e.*, squandered assets, is a very subjective determination. One person’s extravagance or luxury is another person’s sense of purpose or quality. So it would be very difficult to garner taxpayer consensus about when waste occurs as an abstract matter.

Believe it. If every charity had to calculate and report the amount of tax dollars by which they were subsidized, taxpayer in-fighting about which expenses incurred by a given charity are wasteful would abound. Taxpayer demands for accountability about what was done with government dollars at Charity A, to which they have no special allegiance, might be pitted against the loyalty of other taxpayers who view Charity A as their most favorite charity that has wisely used the subsidy. This is because the groups of taxpayers who support and serve charities through deductible charitable contributions are very large and diverse, and so are the entities considered charities under the tax law, which sometimes have conflicting (if not polar opposite) missions.

For example, as Professor Ray Madoff pointed out in a 2008 New York Times Op-Ed piece, Leona Helmsley, the “queen of mean” donated $8 billion, of which $3.6 billion came from taxpayers, to “go to the dogs” by funding charitable grants to be used for the care and welfare of dogs. Fortunately, or not, depending on one’s perspective, additional language in her charitable trust allowed a court to rule (on petition of the trustees of the trust) that the trust could be used for other purposes as well. In 2009, “[w]hen the [trustees] announced its first round of grants amounting to $136 million, animals received leftovers-only $1 million.” Although many dog-owners were appalled and expressed anger at the diversion of funds away from dogs to other charities, particularly given Ms. Helmsley’s clear love of dogs, it’s doubtful that most taxpayers, even those who love their pets enormously and might well support some governmental recognition, and even tax support of this fact, would vote for a $3.6 billion government subsidy of dogs given other priorities, particularly in these economically depressed times. To put the $3.6 billion in perspective, it equals roughly half of what the government spends on Head Start, benefiting 900,000 children. Given the national and global problems and challenges of today, it’s likely that a number of American taxpayers, if not most (even many avid dog lovers), might view the care of pets as a personal responsibility rather than a governmental one. In other words, in the absence of a public health issue or emergency situation (like Hurricane Katrina or a similar natural disaster) that specifically endangers pets in a unique way (and hampers evacuation of owners who don’t want to desert their pets), it’s unlikely that a majority of taxpayers would agree to the significant expenditure of tax dollars on dogs that could have been the result in the Helmsley case.

155 See Brody Subsidies, supra note 27, at 757.
157 This is because Mrs. Helmsley’s fortune was sufficiently large enough to warrant an estate tax rate of 45%. However, since her gift fell within the definition of a “charitable” mission, the $8 billion was 100% deductible by her estate against the estate taxes owed. Madoff, supra note 156. So the “$8 billion was really a gift of $4.4 billion from Ms. Helmsley and $3.6 billion from you and me.” Id.
158 FISHMAN & SCHWARZ SUPPLEMENT, supra note 42, at 7.
159 See Id.
160 Madoff, supra note 156.
Some might argue that this point focuses more on the worthiness of a particular charitable pursuit over others vis-à-vis taxpayer preferences, and not necessarily about ILCEE waste that involves the excessively exorbitant expenditure of dollars for a particular item or service by charities. But the diversity of taxpayer interests and allegiances is at the heart of the issue of ILCEE waste. This is because ILCEE waste is not easily identified by any consensus definition by taxpayers, and many commentators agree that such lack of consensus is precisely why the taxpayer subsidy is delivered indirectly through tax breaks (i.e., tax expenditures) rather than directly through government grant.\footnote{See Brody Subsidies, supra note 27, at 757.}

As noted by the economist Estelle James, "an agreement to disagree (or, perhaps, a ‘you support my cause and I’ll support yours’ agreement) [is at]…‘the heart of why we use the indirect tax subsidy method rather than direct subsidies (in the form of grants)’ to support charities:"\footnote{Id., citing Henry Hansmann, The Evolving Law of Nonprofit Organizations: Do Current Trends Make Good Policy?, 35 Case. W. Res. L. Rev. 807, 830-31 (1988-89) who, in turn, is quoting the comments of Estelle James. See also John G. Simon, The Tax Treatment of Nonprofit Organizations: A Review of Federal and State Policies, in THE NONPROFIT SECTOR: A RESEARCH Handbook 67, 94-95 (Walter W. Powell ed., 1987).}

\[O\]ne of the reasons why we use the indirect tax subsidy approach is that we are a very heterogeneous society. As such, we find it difficult to agree on which functions to subsidize. We could give a lot of examples of organizations where people would generally disagree whether this was a “public good” or a “public bad.” We avoid making these choices explicitly by decentralizing our decision-making. We say, for example, that people vote for an organization by donating to it. As we start to exclude or include, “fencing in” or “fencing out” certain functions, we are going to have to make explicit collective choices rather than implicit individualistic choices. This may be a much more difficult process – so we simply avoid it by choosing the indirect tax subsidy instead of the direct subsidy approach.\footnote{Id.}

\[D.\] Recap of the Reasons

In sum, I maintain that the tax expenditure method of funding fosters such lack of transparency about the nature and extent of the government funding of charity that it masks the public subsidy to the point of totally obscuring this reality from the average taxpayer’s consciousness. This, in turn, causes the average taxpayer to view charities as wholly or primarily privately funded entities which are the concern of the individual in her capacity as a potential consumer, rather than her concern in her capacity as taxpayer. Thus, the average individual doesn’t view ILCEE waste as a taxpayer problem and therefore it doesn’t receive the same level of scrutiny and corrective political response as other types of government-financed waste.

Moreover, even if average taxpayers were made more aware of the extent of government funding of charities (like some more sophisticated taxpayers are already), the dual nature of the private/public financing of charities presents substantial challenges to obtaining any taxpayer consensus about what is considered wasteful. This definitional problem is another independent reason (though still related to the lack of transparency
reason) for the insipid response of taxpayers to ILCEE waste relative to other types of government waste. Regardless, every person has some point at which she would agree expenditures are wasteful. I try to address this difficulty of consensus in my proposed solution to ILCEE waste discussed in Part V. Meanwhile, let’s agree to agree that when I speak of ILCEE waste I’m speaking of a level of expenditure for which there would be a definite majority taxpayer consensus about its excessiveness. Assuming this, the next issue to examine is how ILCEE waste occurs in a universe of potentially unlimited charitable need?

III. RESTRICTED GIFTS – A BREEDING GROUND FOR ILCEE WASTE

One must ask how particular charities have been able to fund expenditures that might rise to the level of ILCEE waste given limited resources for dealing with the insatiable, massive charitable problems of the world, like hunger, literacy, disease, and natural disasters? Where do charities find the resources to spend what some would consider exorbitant amounts on particular charitable matters at the apparent sacrifice of other equally troubling charitable needs? The answer to this question lies with the concept of the “restricted gift,”164 a staple of charitable giving.165

A. The Ecstasy & Agony of the Restricted Gift

The panoply of charitable purposes enumerated under IRC §501(c) (3), (i.e., the types of benefits to be received by society)166 are so fiscally challenging and enormous from a global perspective that they could easily entirely consume the world’s charitable resources for any period in time. But donated charitable dollars are not fully fungible and inter-changeable; many, if not most, charitable donations are subject to limited use constraints. These constraints result in what are termed “restricted gifts.” A restricted gift is typically defined as a gift to a charity that’s limited to being used for a particular

164 “A restricted or special purpose gift is a gift given with one or more conditions attached. These conditions typically specify a purpose for which the donor requires the gift be applied once it is in the hands of the …[charity]. The classic restricted purpose gift endows some particular project or programs. Examples would include gifts to support the women’s basketball team or, more broadly, women’s athletics; or a gift to support a particular college or program – the law school or the Russian language program; or a gift for the purpose of maintaining the stained glass windows in the university chapel. Gifts can also be restricted as to the management or investment of funds and as to the application of income or principal to the specified purpose. In all events, however, a restriction attached to a gift requires that the …[charity] segregate the donated funds in its financial records and employ them only in ways consistent with the donor’s specifications. …[and] the restriction obtains in perpetuity(or until the subject funds are exhausted).” Iris J. Goodwin, Congressional Roundtable on College Endowments-Restricted Gifts Testimony 1 (University of Tennessee Knoxville College of Law legal Studies Research Paper Series, Research Paper #86, November 2009) http://ssrn.com/abstract=1268999 (last visited Feb. 16, 2010)[hereinafter Goodwin Testimony]. Also see Iris Goodwin, Ask Not What Your Charity Can Do For You: Robertson v. Princeton Provides Liberal-Democratic Insights Into the Dilemma of Cy pres Reform, 51 Ariz. L. Rev. 75, 96-99 (2009)[hereinafter Goodwin, Ask Not ]. Also see generally John K. Eason, The Restricted Gift Life Cycle, or What Comes Around Goes Around, 76 FORDHAM L. REV. 693 (2007).

165 See e.g., Evelyn Brody, Charitable Endowments and the Democratization of Dynasty, 39 ARIZONA LAW REVIEW, 873, 877 (1997) [hereinafter Brody Endowments] (noting that “[n]o law requires a donor to impose a perpetuity on a charitable gift, or to restrict the charitable purpose, but donors commonly do both.”)

166 Ten categories qualify as charitable. See supra, note 130 for listing.
purpose, like sheltering of stray dogs (but not cats or other domesticated animals) or caring for octogenarians over 95 years old (but not those younger) or for a particular time-period of beneficiaries (like scholarships for the children of interned Japanese or WWII veterans, but not Japanese-Americans generally or other veterans), or for people living within a particular geographic location (like the poor people of a given county but not for the wider surrounding region), etc. Constraints on uses of restricted gifts mean they’re not available to assist in eradication of other charitable needs of the universe.

Restricted gifts originate in two ways: 1) gifts constrained in use by the structural limitations of donee-organizations (entity-restricted); and 2) gifts constrained in use by specific limitations imposed by donors (donor-restricted). As to the former, with limited exceptions, a mere donation to a particular charity (even with no express use restrictions) may mean that the donated funds must be used for the narrow purposes of that charity as set forth in the Articles of Incorporation or other charter documents of the charity, unless the charity-donee has relatively broad purposes. Thus a gift to a homeless shelter may be limited to being used for sheltering the homeless and not necessarily to providing therapy to the mentally ill, even though the mentally ill may comprise a large segment of the homeless population. The second type of restricted gift, the donor-restricted gift, applies when a donor expressly or impliedly limits the use of her particular gift to specific projects or expenses of the already limited-purpose charity. Donors regularly engage in this practice. As elaborated below, the first type of restricted gift, the entity-restricted gift (the ecstasy), is generally seen by a charity as universally good. On the other hand, the second type, the donor-restricted gift (the agony), can be a mixed blessing and may only be merely tolerated in some instances, even when precipitated by the charity’s overtures.

1. The Ecstasy – Pluralism Heralded

When a gift restriction is imposed by the particular purposes of the charity to which the gift is made (i.e., entity-restricted), it’s a victory for the organization’s mission and the passion of its individual supporters. For example, any gift to a charity whose state charter documents confine its mission to relatively narrow particular purposes will result in any gift to that charity being also restricted to those limited purposes, even if the donor made no specific mention of any type of use restriction. Thus, a gift to XYZ charitable museum that pursuant to its charter documents say it’s organized to preserve the history of a small town’s development can be used to archive and preserve every photograph of its before-the-rest-of-the-world-knew-we-existed reality, but wouldn’t be

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167 See Goodwin Testimony, supra note 164.

168 Specifically excluded are self-imposed restrictions on funds adopted by a charity’s board of directors or trustees. These are not true restricted gifts since the self-imposed limits can’t be legally enforced. See Brody Endowments, supra note 165, at 884; National Conference of Commissioners on Uniform State Laws, Uniform Prudent Management of Institutional Funds Act § 2 (2) (2006)[hereinafter UPMIFA].

169 Broadened applications may apply when a charitable recipient of a restricted gift dissolves and terminates. See e.g., FISHMAN & SCHWARZ, supra note 25, at 121; Matter of Multiple Sclerosis Service Organization of New York, Inc., 68 N.Y.2d 32(Ct.App.1986), 496 N.E.2d 861 (1986).

170 FISHMAN & SCHWARZ, supra note 25, at 120-121.127

171 Id., at 121.

172 See FISHMAN & SCHWARZ, supra note 25, at 120-121, subject to the possible exception referenced supra, in note 167.
able to help the drug addicts or poor people who now live in that community. On the other hand, it’s the very restriction of XYZ’s organizational purpose that contributes to its vibrancy and separate existence. Were it not for XYZ’s uniqueness, or maybe more accurately stated from the perspective of the charity, its market niche, XYZ charity would likely not be able to exist. Its unique focus is what appeals to a particular group of supporters who donate to XYZ when they don’t necessarily donate to other charities. Each charity’s uniqueness, multiplied by every other unique charity and its supporters, in turn fosters and nurtures our society’s diversity and pluralism and ultimately, maybe, the very core of our democracy. And it’s precisely this niche appeal that’s one of the most foundational aspects of why the nonprofit sector endures in our society.173

Niche charities are the heartbeat of the nonprofit sector precisely because they’re typically initiated and supported by organizers and patrons who have a passion for its unique mission that isn’t necessarily supported by a broad-swath of society. Thus, every donation to a specific-purpose charity validates and reinforces this nation’s plurality,174 as well as that particular organization’s niche market. Moreover, if a donor-restricted gift is made for narrower purposes than those set forth in the charity’s general charter documents, they are attractive. “Such gifts are appealing not only for their characteristic size, but the donor-designated purpose is useful as an external endorsement of or perhaps a new direction for some facet of the charity’s work.”175

These are definitely positives. But as with most positives, there’re flip-side negatives.

2. The Agony – Hamstringing the Halo

Just as charities are enriched by their uniqueness, their flexibility is also limited by their specific organizational purposes. At an initial level, as previously stated, donor contributions to a special purpose charity (which most entity-restricted gifts are) limit the use of those charitable dollars to the charity’s purpose.176 If a local dog shelter is well funded but a local charity to help senior citizens is not, the dog shelter generally can’t suddenly decide to share its existing funds with the senior charity. Its purpose restrictions under its charter documents would limit its flexibility to address broader charitable issues.177 In contrast, had at least the deductible part of the monies in the hands of a charity been collected as federal taxes instead, then the federal government

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173 See supra discussion Part I.B.2.b.
174 Id.
175 Goodwin, Ask Not, supra note 164, at 98.
176 This is one reason why the corporate form (versus the trust form) is often favored for charities because it more easily allows charity boards to amend mission statements in charter documents to respond to changes in needs precipitated by global and/or regional situations or technology and the like. When a charity is set up as a perpetual nonprofit corporation (including a private foundation), state law default rules will typically allow these types of amendments. If, however, the charity is established via a charitable trust created by the initial donor, that donor will need to include amending authority by the trustees in the original trust documents, which isn’t typical for purpose limits. This subtle, but significant, difference is because corporations require state law pre-approval and franchise, while charitable trusts are seen as a matter of private law enforcement and sanction by the state, so the permissible activities of a charitable trust authority originates from the donor’s expression.
177 An exception could occur for later gifts if the dog shelter amended its charter documents to allow expanded purposes that might include any charitable endeavor. See supra note 173. It’s doubtful the charity managers would initiate such an amendment since it’d endanger the charity’s niche market.
would be able to allocate funding, via grants to specific charities or government projects, to the highest need at a given point in time.

A charity’s inflexibility is compounded when they receive donor-restricted gifts that limit the use of funds even further by dedicating them only for particular projects or expenditures of the charity. Particular projects or expenses, like new buildings or physical plant improvements, or new educational outreach programs of a charity, provide opportunities for charities to solicit special-purpose funds in cases where donors might not otherwise be motivated to contribute. Sometimes, donors motivated by these solicitations expressly indicate that the use of their donations must be limited to the building, outreach or comparable narrow-purpose matter. But even when donors don’t provide express limits, charities understand that gifts received in response to such narrow-purpose solicitations generally also must be considered implied restricted gifts as a matter of prudence. But such donor-restricted gifts, in ways similar to entity-restricted gifts, even more acutely “can quickly become a mixed blessing.” Accordingly, a charity may be hamstrung as to how it uses donations specifically solicited for a particular purpose or cause. In fact, a charity may even be prodded and prompted in the programs it undertakes by the responsiveness of donors to particular overtures. “There is no doubt then that, under current law, [donor]-restricted gifts, have a significant effect on an organization’s ability to respond to change within the context of its overall mission. Whatever the law might require, the charity can only be loath to stand by and watch as endowed programs once cutting edge become anachronistic, while other needs arise only to go unmet.”

The above overview is a beginning explanation about how over-funding for a particular project/mission might occur to the point that ILCEE waste is possible. But the overview doesn’t fully elaborate on possible circumstances, procedures and incentives that could explain why donors give too much for a particular cause/mission. Hopefully, the patterns of donor-giving posited below provide further enlightenment.

B. How Restricted Gifts Give Rise to ILCEE Waste – 4 Scenarios

If a donor contributes $100,000 to a special purpose charity (like a charity organized for the sole purpose of assisting disabled kids of a particular small-town) or a particular project of such a charity (like producing an annual Special Olympics or funding a field trip for the disabled kids of the community), that charity is typically impelled to spend $100,000 on the special purpose or particular project, even if the purpose or the project objectives could adequately, or even, comfortably be achieved for $70,000. Because of tax complications and other reasons, the $30,000 excess is
available funds wouldn’t likely be returned to donors for want of need. And because of the significant practical and legal difficulties, neither do charities typically ask donors or the courts to relax or waive the use restrictions on the funds to free them up for other projects and expenses of the charities. Instead, the excess funds are used by charities to contribute to the sometimes lavish (versus necessary or comfortable) completion of the gift’s restricted purpose or project.

This raises the crucial question that introduced this section. Why do donors, who likely have multiple charitable passions and limited resources to devote them, contribute “too much” to a particular charity or charitable project? The reasons are complex, but are all related to versions of restricted gift patterns. Possible scenarios are described below.

1. Scenario 1: Unexpected Response to Charities’ Mass Appeals for Help

Americans have a strong and incontrovertible history of exhibiting tremendous generosity for victims of disasters – whether man-made or natural disasters - like in the wake of the terrorist attacks on 9/11/2000, or natural disasters such as Hurricane Katrina in 2005, the 2004 tsunami in Indonesia or, most recently, the awful 2010 earthquake in Haiti. In the wake and aftermath of such disasters and crises, charities always make what are termed “mass appeals” for donations to aid the victims of the specific disasters. If responses to these mass appeals are greater than expected then the funding available for victims of a given disaster or tragedy is more than the charity, and possibly any charity donee, anticipated spending on a given individual victim, or . . . maybe not. For example, a clear incidence of disconnected expectations between a charity that initiated a mass appeal and a public that responded was exhibited by the public outrage over the announcement of the American Red Cross in the wake of 9/11. The American Red Cross announced that the response to its mass appeal for 9/11 was so enormous that it would reserve sizeable funds generated from the appeal for other non-9/11 disasters. This was probably a prudent decision based on efficiency criteria, but a risky one legally; there’s case law indicating that gifts given in response to specific appeals may be impliedly restricted to the appeal purposes, even when there’s no express restriction stated by the donor. In any case, so many donors were outraged that their 9/11...
donations might go to other causes that the Red Cross was compelled, for public relations reasons, to reverse its decision after it was clear its reputation had been marred.\footnote{Id.}

While it’s very unlikely that the mass appeals made in the wake of the recent Haitian crisis\footnote{See e.g., Marc Lacey, Estimates of Quake Damage in Haiti Increase by Billions, N.Y.TIMES, Feb. 17, 2010, at A6., available at http://www.nytimes.com/2010/02/17/world/americas/17haiti.html?scp=5&sq=Haiti%20disaster&st=cse.} could ever fill the maw of need in the aftermath of that tragedy, other crises are more limited in impact and geographical scope and responses could well exceed expectations.\footnote{See generally Buckles, supra note 186; Shenoi, supra note 186.} In these situations, is the answer to offer too much help to the victims of the disaster that generated the excessive donations or to apply those donated resources elsewhere? How does a charity decide what’s too much help for a given group of victims? Should a charity risk backlash from the public for not expending all funds generated by the mass appeals for that disaster? Or should excess dollars be directed by the charity to where they’re most needed in terms of pressing, changing current events? These are hard choices for a charity to make – risking alienation of donors or insufficient response to future victims. The anti-exorbitance/ILCEE tax proposed in Part V would provide not only incentive, but also legal repercussions charities could cite to donors as an argument for altering the application of some mass appeal funds to serve other needs.

2. Scenario 2: Unexpected Value Increase – The Buck Trust Example

A not-so-wealthy (or at least, not massively wealthy) donor might say “I’ll give as much as I can spare,” knowing full well that given the cost realities of fixing the problem she’s focused upon, her contribution is highly unlikely to lead to any over-funding of the solution(s) and at most might lead only to some problem mitigation. An example might be housing of the homeless in a small town. But then, due to market forces and circumstances, a significant appreciation of her assets\footnote{This might also be joined with decreases in costs as discussed infra in subpart 3 of this Part III.B.} occurs after the gift date, resulting in a clear surplus of funds given the restricted gift’s purposes. These facts are similar to one of the most famous trust law cases - In Re Estate of Buck.\footnote{In Re Estate of Buck, No. 23259 (Cal. Super. Ct. Marin County, Aug. 15, 1986) (reprinted in full in 21 U.S.F.L. REV. 691 (1987). The case generated considerable controversy and commentary. See generally FISHMAN & SCHWARZ, supra note 25, 109-110 (citing extensive authorities discussing the case); CAFARDI & CHERRY, supra note 107, at 41-42; MARION R. FREEMONT-SMITH, supra note 27, at 182; John G. Simon, “American Philanthropy and the Buck Trust”, 21 U.S.F.L.REV.641 (1987); Frederick D. Schrag, Comment, Cy pres Inexpediency and the Buck Trust, 20 U.S.F.L. REV. 577, 584-587 (1986);Wendy A. Lee, Note, Charitable Foundations and the Argument for Efficiency: Balancing Donor Intent with Practicable Solutions Through Expanded Use of Cy pres,34 SUFFOLK U. L. REV. 173,187-189 (2000-2001).} By a 1973 will, Ms. Beryl Buck left the majority of her estate (the value of which was unknown at the time) to be used for the “care of the needy in Marin county and for other nonprofit charitable, religious or educational purposes in that county.”\footnote{Will of Beryl H. Buck at article ten, In Re Estate of Buck, supra note 193.} After Ms. Buck’s death, only 2 years later, in 1975, the San Francisco Foundation (SFF), a community foundation responsible for a number of other assets, was appointed as manager of the Buck Trust. At the time of SFF’s appointment, the geographical
restrictions for use of the funds posed challenges because Mann County, then and now, was and is a relatively small geographical area and population (less than 220,000 in 1975) and one of the wealthiest counties in California based on per capita income. So the so-called “charitable” needs of this County were already questionable. But this issue became even more magnified by the appreciation in value of the Buck Trust assets. At the date of Ms. Buck’s death in 1975, the value of the trust was estimated to be $7 -10 million. But just a mere 4 years later, in 1979, the trust assets were valued at approximately $260 million, after Shell Oil purchased the small oil company whose stock comprised a significant part of the Buck Trust assets in 1979. And in 1985, less than 10 years after the bequest, the trust’s value had climbed to over 40 times its maximum 1975 value to a whooping $400 million. "Such a dramatic leap in the level of the gift, taking it from a respectable but unspectacular level to one of the two dozen largest charitable funds in the country (and probably in the world), unavoidably raise[d] th[e] question: is it reasonable to assume that a donor’s distributional pattern will be the same for X dollars as for 40X dollars?"

SFF trustees were so concerned about using this much money for the limited charitable needs of such a wealthy county as Marin that they sought to have the Buck Trust terms judicially modified under the common-law judicial doctrine of cy pres to prevent what they saw as an inefficient, i.e., wasteful, use of charitable dollars. They wanted to expand the geographical reach of the Buck Trust to the greater San Francisco Bay Area. Unfortunately, their efforts were thwarted by state law limits on the ability to change charitable trust terms and also by local political opposition. Still, SFF’s efforts generated years of scholarly academic articles and initiatives during and post these efforts to change state laws to allow more flexibility to deal with ILCEE waste. These efforts and the adequacy of the reforms they generated are discussed in Part IV. Meanwhile, suffice it to say, that appreciation in the value of assets of restricted gifts is a significant reason why an over-funded gift might occur.

2. Scenario 3: Unexpected Technological or Societal Advances

Some problems are so intractable that donors know up-front that enormous amounts of moneys are needed to solve them. If a very wealthy donor considers something an important problem that requires priority focus and she also has significant resources, then she might well say, “I’ll throw everything I can spare” at this specific problem, hoping her contribution (typically by a Will, effective at death) will make a significant dent in the problem’s resolution, if not eradicate it. This donor doesn’t worry or even imagine that her contribution might be more than is needed to solve the problem. But a cure for the problem could turn out to be less costly than anticipated due to technological, strategic or other advancements, like the discovery of a vaccine for a disease (like for polio and tuberculosis), or improved delivery systems such as new roadways in undeveloped countries. Also, a number of wealthy donors with the same

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195 FISHMAN & SCHWARZ, supra note 25, at 109-110
196 See generally supra note 193 and authorities cited therein.
197 Simon, supra note 193, at 646.
198 Id. See also infra Part IV.A.2. (discussing the cy pres doctrine and the Buck Trust results).
199 See generally supra note 193 and authorities cited therein. See also infra Part IV.A.2.
200 See infra Part IV.A.2.
“I’ll-give-a-lot” mindset could make collective contributions that put the needed funding over the tipping point of the fix-it cost. Then, the resulting donations will give rise to too much money for accomplishment of the targeted mission unless the mission is expanded beyond original parameters. Sometimes this may lead to a better outcome, but sometimes it could lead to a lavish outcome amounting to ILCEE waste.

4. Scenario 4: Unanticipated Shifts in Societal Priorities

Another type of excess funding of a given purpose might occur because society’s view of the goods or services being funded by the charitable expenditure(s) may change from those seen as useful to those seen as excessive because of shifting economic priorities or societal values. In other words, the value of the benefits received are not over-priced and may even be benefits that in other times might seem very appropriate. But given the priorities of society and its relative wealth at any given moment of evaluation these same expenditures can be eventually viewed as exorbitant for the times. This type of excess is a moving target. However, it’s one that must not only be considered, but absolutely anticipated. Moreover, it’s one of the scenarios currently at issue in these difficult economic times, precisely because societal priorities and values have shifted since the pre-2008-2009 economic crisis.

C. Bounded Rationality

As indicated above, all four of the restricted gift scenarios that might lead to ILCEE waste are often the product of well-intentioned altruism by a donor. But there’s an over-arching problem that plagues any restricted gift that isn’t completely used quickly – the problem of the unknown, unanticipated and unknowable. Frankly, it’s hard to predict the future - the limits of transactional and situational predictability because of limited information, time, mental capacity, etc. - called “bounded rationality” are well established - and donors are no better at it than anyone else. When donors establish restricted gifts the gifts may become anachronistic, making it difficult for a charity ability to adjust to unforeseen varying needs and times, particularly because there’re no easy options for adjustment, accommodation or re-evaluation in light of changed circumstances.

D. Endowments and Private Foundations As Most Implicated

Over-funding leading to ILCEE waste is a significant possibility in all the scenarios discussed above. But as between the four scenarios, I believe the likelihood of ILCEE waste is least in the mass appeal (Scenario # 1) context and greater in the other three.

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201 When I speak of “better” outcomes I mean those that might provide more benefit, in terms of either providing the targeted benefit to more people than originally anticipated (e.g., by expanding geographical or economic outreach), or providing more benefits to the targeted populace, or a combination of both.

202 See supra, Part I.B.3.


204 See supra note 180 and accompanying text.

205 See supra, note 184. Also see infra Part IV.A.2.
1. **Assessing ILCEE Waste Potential in the Various Restricted Gift Scenarios**

In mass appeal situations, market forces will eventually limit continued broad-based contributions to an already over-funded charity once the excessive response to a mass appeal is revealed in the media. There may be a greater lag-time with some horrific situations like with the 9/11/2000 attack, but the uniqueness of the relatively limited density of impact and high-profile nature of that situation does not occur often in history.\(^{206}\) Thus, the potential for over-funding for restricted purposes that might lead to ILCEE waste is more likely to be contained in the mass appeal context. In addition, the most commonly used restricted gift structures are those usually referred to as “endowments” and “private foundations” respectively, discussed below, which are typically not appropriate in the mass appeal setting. With mass appeal cases, particular charities are likely to receive a lot of small donations from a massive number of people. Most mass appeal responders are unlikely to structure their gifts via use of specialized charitable structures or entities because the amounts of their gifts don’t warrant this added effort and potential cost or the donors are unlikely to even know about different charitable structures. They simply write a check, click a contribution link, or text a contribution to XYZ Charity in response to a particular appeal by the charity, such as happened in the recent 2010 Haitian earthquake tragedy.\(^{207}\) Attempts by charities to re-allocate funds from the source of a mass appeal to other uses might receive significant adverse publicity because of the broad-based public response to the mass appeal.\(^{208}\) However, these are likely situations where charities are trying not to cause ILCEE waste, but public response to attempted reallocations may cause ILCEE waste. For these reasons, ILCEE waste in the mass appeal context is possible but less likely to be regularly recurring or concentrated in specific charities (rather than inefficiencies arising from multiple charities) when it occurs. Rather it’s very intermittent and mass appeal specific.

In contrast, the other three scenarios offer expanded possibilities for ILCEE waste. This is because donors of significant amounts of money focused on a particular purpose are likely to seek professional assistance in structuring their gifts to insure their specialized uses or restricted gift parameters are followed. And for these large donors, the primary structures suggested are likely to be: 1) an endowment, or 2) a private foundation or some variation on, or combination of, the two, as next explained.

2. **Endowment Funding**

An endowment (also called an endowed fund, endowment fund or simply an endowment) is essentially a gift to a charity of such a sufficiently large sum of money that the annual earnings on the principal – such as interest and other investment earnings - are typically large enough to finance large portions of the operations of the endowed charities. Donors of endowments typically expressly make access to the corpus/principal

\(^{206}\) *See supra*, note 185-191 and accompanying text.


\(^{208}\) *See supra* notes 185-191 and accompanying text.
contribution or gift to the charity usually untouchable by the charity for current-day operating expenses, so as to structure the gift as a perpetual fund that’s invested to generate year-after-year of earnings off the corpus/principal. Donors want to limit or prevent the ability of the endowed charities to dip into the core monies of the endowed funding source for day-to-day operations. So endowments allow charities to have a reasonably reliable income stream even when contributions and revenues from annual donors and yearly operations, respectively, might be low.

Most importantly to this article, endowment funds are the types of donations most typically structured as restricted gifts with limitations dictating their use only for particular purposes. Since a given charity can hold multiple endowment funds for varied restricted purposes, there can be a compounding effect of inflexibility attributable to restricted gift funding. Moreover, the perpetual nature of endowment funds makes their restrictions even more troublesome because they are particularly susceptible to the bounded rationalities of donors. Thus, endowment funds considerably constrain a charity’s application of charitable funds to the highest and best use at a given point in time. Even worse, restricted endowments may absolutely require dedication of significant expenditures to matters which most might agree are completely unnecessary, anachronistic and/or of extremely low-priority in the face of changing realities and priorities, and accordingly could result in ILCEE waste. So a restriction that may have huge relevancy when imposed by a donor (and thus broad-based usage), could become excessive in future years when needs or priorities have changed. For example, this point was at the core of one of the most recent highly-newsworthy charity-versus-donor disputes that began in 2002 and settled out of court in 2008 – the *Robertson vs. Princeton* case.

Although generally requiring significant documentation, endowments can be set up with relatively minimal effort by a donor by only articulating express endowment funding directives to the charity to which they are given. They are typically gifted to established charities, like colleges and universities or museums, by donors of very large wealth who usually endow funds representative of this wealth. In contrast, funding of restricted gifts via a private foundation always requires more effort and documentation because a new tax-exempt entity (i.e., the private foundation) must be created and apply for tax exemption. Still, private foundations are often used as good vehicles for capturing endowed funds and/or gifting restricted-purpose funds.

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209 See UPMIFA, supra note 168 (stating, “‘Endowment fund’” means an institutional fund or part thereof that, under the terms of a gift instrument, is not wholly expendable by the institution on a current basis. The term does not include assets that an institution designates as an endowment fund for its own use.”); See also, Susan N. Gary, *UPMIFA Coming Soon To A Legislature Near You*, 21 PROBATE & PROPERTY 32, 33-35 (2007).

210 See Goodwin, *Ask Not*, supra note 164, at 82-96 (describing the restricted gift, the litigation and the settlement.) A 1961 gift by Charles and Marie Robertson to Princeton, which at the time was hailed as the largest single gift of its kind from any individual benefactor to a university, was made to Princeton (via the use of an intermediary private foundation) to advance careers in U.S. civil service. However, the drop-off of students interested in federal government service in the post-Kennedy and King assassinations/post-Vietnam era lead Princeton to apply the funds more liberally based on a broad interpretation of the gift restriction language. This lead to a dispute with the private foundation that had been set up by the Robertson’s to disperse the funds to Princeton. *Id.*
3. Private Foundations

“Private foundation” is a term that has distinctive legal meaning under the IRC. Essentially, in terms of the primary tax subsidies provided to charities - tax deductibility and tax exemption - charities are divided into two sub-categories for tax purposes – a) those that fit the definition of a "private foundation" and b) those that don’t, customarily called “public charities.” By far, public charities represent the largest group of charities. Private foundations stand in contrast to public charities because public charities are typically funded by lots of donors and thus accountable to a broad-based patronage of support. On the other hand, private foundations are primarily funded by an individual or a small group of individuals, rather than a large number of donors. This doesn’t mean that the missions/purposes of private foundations don’t have broad-based political and social support, only that the monetary support for these charities (and also likely control of them) comes from fewer sources.

Typically private foundations are created by wealthy donors who don’t want to undertake day-to-day operations of a charity, like feeding the hungry, educating minors, or disaster relief. Founders/donors of private foundations usually organize these entities in order to stay in control of grants they make to public charities which are aligned with their interests and are performing the operations they want funded. “What they do, mostly, is give away money to organizations which then do the charity. Private foundations, then, are basically funding organizations.” Quite commonly, the private foundation is started by one large endowment from a philanthropist or a business corporation. “Since private foundations are bona fide [charities], they may attract additional tax deductible gifts, but their major source of income is the investment income produced by their endowment.” The Bill and Melinda Gates Foundation is an example of a private foundation that generally is viewed positively by society in terms of its goals and purposes. However, Jill and Joe Public are unlikely to consider donating to

211 IRC §§509(a) (1)-(4). These IRC sections essentially contain a negative definition of private foundation in that they identify what types of IRC § 501(c) (3) charities are not private foundations. Basically any organization described in IRC §501(c) (3) that is, or is viewed as being, widely supported by a number of patrons rather than the contributions and control of a more limited few will be considered a public charity. See generally MARION R. FREEMONT-SMITH, supra note 27, at 265-267; CAFARDI & CHERRY, supra note 107, at § 19.02; FISHMAN & SCHWARZ, supra note 25, at 751-771.

212 See supra, Part I. B.2.

213 Also, there are 2 categories of private foundations, “operating” private foundations, and “non-operating” private foundations. But the distinctions between these categories are not discussed herein because most private foundations are non-operating. See FISHMAN & SCHWARZ, supra note 25, at 751-771.

214 See generally FISHMAN & SCHWARZ, supra note 25, at 751-771; MARION R. FREEMONT-SMITH, supra note 27, at 3-4 & 264-266; CAFARDI & CHERRY, supra note 107, at §19.02; AMERICAN BAR ASSOCIATION, SECTION OF BUSINESS LAW, NONPROFIT GOVERNANCE AND MANAGEMENT, 680-681 (Victor Futter ed.2002). The term “public charity” has no specific legal meaning under the IRC. Rather it is a term normally used in every day parlance to indicate that the charity is not a private foundation

215 See supra note 213 and authorities cited therein.

216 See CAFARDI & CHERRY, supra note 107, at 309.

217 CAFARDI & CHERRY, supra note 107, at 309.

218 Id.

219 Id.

this charity because it was so generously funded and endowed by its creators, Bill and Melinda Gates, when it was established.

Viewed from their most positive perspective, private foundations are high-level monitoring and grant-making entities that oversee operating, public charities performing the charitable functions they’ve funded. But on the darker side, because of the lack of public oversight that typically coincides with having broad-based public support, private foundations can turn into private governments controlled by a few individuals (typically its founders) who hoard or lavishly spend tax-exempt dollars for their own agenda, like employing family members at excessively high salaries. It’s because of this abuse potential that Congress created the two classes of charities and wrote very special rules for private foundations into the IRC to curb the high potential for abuse inherent in the structure of these organizations.221 The special tax rules applicable to private foundations contain a lot of provisions to curb conflict of interest/self-interested expenditures and hoarding in the private foundation context but only one rule that might be used to prevent ILCEE waste.222 The next Part argues that this rule and others are inadequate to the task.

IV. INADEQUACIES OF CURRENT LAWS

Even if taxpayers could overcome the perception problems identified in this article about ILCEE waste - the lack of transparency of the tax expenditure financing method, the abdication/subjugation of taxpayer oversight role to that of consumer, and the inherent difficulty of defining waste223 - to coalesce public outrage about excessive expenditures in the non-profit arena, there’s currently very little in state or IRC tax-exemption laws to prevent ILCEE waste. That’s why I believe a tax law solution is needed. But first, let me elaborate why current laws that might be of assistance in the charitable context are inadequate to the task of preventing or at least curbing ILCEE waste. Accordingly, the following are considered and discussed in this Part:224 A) the common-law doctrines of waste and cy pres, both variable from state to state; and B) the IRC rules contained in Sec.501(c) (3) against “private inurement” and the no more than incidental non-inurement type “private benefit;” those contained in Sec. 4958 imposing an excise tax on excess benefit transactions; and those in Sec. 4945(d) (5) levying an excise tax on “expenditures for non-charitable purposes” by private foundations.

221 See FISHMAN & SCHWARZ, supra note 25, 760-771; CAFARDI & CHERRY, supra note 107, at 309.
222 See IRC §4945(d), discussed infra Part IV.B.3.
223 See supra, Part II.
224 Deliberately excluded are regulations or laws applicable to grant or contract oversight expenditure responsibilities by government or private foundations, because governmental grants and contracts are not a likely significant source of ILCEE waste. See supra, notes 57-63 and accompanying text. Also, illegal expenses (because of breaches of state law fiduciary duties owed by all entity managers (for-profit as well as nonprofit) of care, loyalty or obedience, etc., or because of tax law violations) aren’t included in this discussion because such illegal expenses don’t constitute ILCEE waste as defined in this article since they’re redressable by means other than that proposed by this article. See supra Part I.A.1.
A. State Law Doctrines of Waste and Cy Pres

1. The Waste Doctrine’s Limited Focus

Every first-year law student learns in property class about the common law doctrine of waste, or more properly stated, the doctrine against waste.225 The doctrine’s name sounds like it ought to help with the ILCEE waste problem. But, unfortunately, the common-law waste doctrine doesn’t really address ILCEE waste situations, or what Professor Edward McCaffery, terms “nonurgent expenditures.”226 Rather, the doctrine of waste gives huge deference to the rights of property owners to do with their property as they desire – including, in most circumstances, the right to absolutely destroy the property when no one else’s property right is affected by this destruction.227 Yet, given that this society so abhors waste of all kind, including waste attributable to extravagance,228 how could we not have a doctrine against waste that repeatedly and consistently infuses that abhorrence in all property and asset management law rules? The answer appears three-fold.

a. Dissipatory Waste Focus

The first reason is that the common-law doctrine of waste primarily addresses only “dissipatory waste”— the outright destruction (i.e., not in exchange for any or adequate value) or the otherwise “using-up” of a limited asset by its owner for less than adequate consideration or exchange value.229 This focus fails to make the distinction between dissipatory waste and the type of waste that involves the squandering of assets on the unnecessary, extravagant or the foolish,230 which is at the heart of ILCEE waste. Although this oversight is lamentable, it is understandable in a capitalist society. As Professor McCaffery eloquently explains:

It is time to mark more clearly a distinction between two conceptions of waste. One is the idea of waste as dissipation: the pure loss of value, ... Think of

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225 For an overview of the common law doctrine of waste, see 2-19 THOMPSON ON REAL PROPERTY, THOMAS EDITIONS §§19.08- 19.09; JOHN G. SPANKLING, UNDERSTANDING PROPERTY LAW, §9.09 (2d. ed. 2007); JOSEPH WILLIAM SINGER, PROPERTY,§7.6.2.
226 McCaffery, Waste?, supra note 152, at 84
227 See Lior Jacob Strahilevitz, The Right to Destroy, 114 YALE L. J. 781, at 783, (noting and elaborating on the point that the right to destroy one’s own property seems firmly entrenched).
228 Even though we have no effective legal sanctions against nonurgent waste, “[w]aste in both its dissipatory and nonurgent senses has been frowned on throughout Anglo-American history.” McCaffery, Waste?, supra note 152, at 91.
229 Dissipatory waste falls into two categories: “affirmative (or voluntary) waste, involving overt actions that diminish the value of the property, and “permissive waste” when inaction and failure of reasonable care results in loss or reduction in value. Id. Moreover, dissipatory waste typically is only actionable when it infringes on rights of others who hold concurrent or sequential rights in the property, e.g., such as in the case of the holder of a future interest in the property who complains about the current possessor’s dissipation before the future interest holder’s rights become possessory. McCaffery, Waste?, supra note 152, at 84. There are exceptions, e.g., for wasteful death directions. Id.
230 The common law originally had limited exceptions which might have addressed the type of extravagant expenditures that are the topic of this article e.g., termed “ameliorative” waste (so called because of attribution to value-added improvements, not appreciated by consequent or concurrent owners). But ameliorative waste has long ago been abandoned by American courts and is disfavored today as a tort action. See Sprankling, supra note 224, at §9.09[A]; Singer, supra note 224, at §7.6.2.
letting the farm go to seed or burning down the house. Such “dissipatory” waste represents no tangible good to anyone; the value disappears into the ether.

The legal and property scholars who have discussed waste – and tolerated the general right to it – have meant it in this dissipatory sense. . . .

[But] the focus on dissipatory waste led legal scholars to conclude that the problem of waste is a self-limiting one, at least once absolute ownership was established. Why would anyone literally throw away value? It is not necessarily so – the fact that dissipatory waste is not common in our culture is more a matter of social and economic institutions, including, importantly, custom and mores, than any necessity . . .

[The] second conception of waste refers to nonurgent, frivolous, or excessive consumption: poor choices of how to spend time or value. . . . Such nonurgent waste does not destroy property but rather moves it into other hands – think of selling the farm for a sack of beans. We might therefore expect that a capitalist society [italics added] be more concerned with dissipatory than with nonurgent waste, and would even use different terms for the two; this might indeed explain the law’s exclusive concern with the former conception of waste.231

b. Deference to Individual Liberty in Property Rights

The second reason the doctrine of waste is not infused with anti-extravagance rules may be that our societal abhorrence of extravagance-type waste is fundamentally a moral abhorrence that doesn’t necessarily translate to legal infringements or prohibitions of the right of the individual to use or not use her money or property on what she desires. This reason is founded in conflict between two fundamental principles, i.e., the conflict of where property law rules meet liberty rules; the latter usually trumping.233 But this category of waste is definitely in need of more regulation and oversight. Again, as Professor McCaffery elaborates, in advocating for the distinction between dissipatory waste and nonurgent expenditures:

… Nonurgent waste, however, presents much different challenges and concerns. Most important, the very absolute conception of ownership that makes dissipatory waste less likely makes nonurgent waste more so. If one can do whatever she wants with ‘her’ property, then many individuals will indeed be irresistibly tempted to spend it all on their own wants, however nonurgent these be from a collective perspective. In sum, the two conceptions of waste are connected, . . . .[b]ut the two conceptions [also] stand apart because the right to waste is de facto rare relative to dissipatory waste, but not rare relative to nonurgent waste. People most certainly do ‘consume, waste or destroy’ all or large portions of their capital.

231 McCaffery, Waste?, supra note 152, at 85-86.
232 “There is something obvious and irreducible in ordinary moral discourse’s condemnation of waste – everybody knows that waste is bad; this is, in fact, largely what the word means. But in moving this moral insight into legal and political contexts, we encounter certain conceptual difficulties. . . .[I]t would, ultimately, be none of our official public business. A social concern with waste would be meddlesome, paternalistic, envious. It’s your property, after all, and you can do whatever you want with it, ‘without being impeachable or accountable for it to anyone’ as Blackstone had put it.” Id., at 91.
233 See e.g., Eason, supra note 164, at 694.
Ultimately, the argument for bringing the second conception of waste into the legal and philosophical analyses of property rights is a normative, not an analytic one.\textsuperscript{234} [italics added].

c. The Definitional Difficulty – Once Again an Obstacle

The third reason why anti-extravagance rules aren’t fully addressed by the common law doctrine against waste is that, as repeatedly previously noted,\textsuperscript{235} extravagance-type waste is extremely hard to define and quantify. It’s one thing to say that waste is abhorred. It’s quite another to define extravagance or extravagant-type waste. Dissipatory waste is much more concrete and therefore easy to spot – something gets eliminated for no consideration or little consideration, versus the too-much-paid-for-too-little-benefit applicable in ILCEE waste situations. Moreover, extravagant type waste has had to fight for place and recognition as a problem to be addressed in the world of the common-law doctrine against waste as an abstract concept, untethered to any moor or standard. In contrast, the common law \textit{cy pres} doctrine, next discussed, at least has the anchoring of donor intent as a reference point for assessing waste. But as I elaborate below, I think this anchoring is also insufficient.

2. \textit{Cy Pres} and Its Recent Reforms Also of Unlikely Help

In addition to the doctrine of waste applicable to both charitable and non-charitable situations, the charitable world has uniquely also had the common law doctrine of \textit{cy pres} to allow modification of a restricted gift when changed circumstances make the restrictions extremely problematic.\textsuperscript{236} Essentially the doctrine allows the designated managers of a charity to seek modification of the terms of a restricted gift when application of the restrictions would be troublesome for specified reasons.\textsuperscript{237} So, for example, a trust to find a cure for polio or a trust to end slavery, which are obsolete missions, could be modifiable under the \textit{cy pres} doctrine to change the purpose to something “as near as possible” to the original intent of the donors.\textsuperscript{238} Unfortunately, until very recently, problematic restrictions only included those considered “illegal,

\textsuperscript{234} McCaffery, \textit{Waste?}, supra note 152, at 87.
\textsuperscript{235} \textit{Supra} Part II.C.
\textsuperscript{236} See generally for an overview discussion of the \textit{cy pres} doctrine, MARION R. FREEMONT-SMITH, \textit{supra} note 27, 173-182; Singer, \textit{supra} note 224, at §7.6.3; FISHMAN & SCHWARZ, \textit{supra} note 25, 106-111; Goodwin \textit{Testimony}, \textit{supra} note 164, at 2-3; Goodwin, \textit{Ask Not, supra note 164}, at 100-102. CAFARDI & CHERRY, \textit{supra} note 107, at 40-42.
\textsuperscript{237} This assumes the other elements for \textit{cy pres} are met. Under the traditional iteration of the common law doctrine of \textit{cy pres}, in order to modify the purposes of a trust, a court needed to find: 1) a valid gift to be used for legitimate charitable purposes; 2) a trigger for the request for modification which were traditionally limited to situations where performance of the trust’s original purposes are either “impossible or impracticable;” and 3) that the donor had a general charitable intention (broader than the donor’s specifically stated purposes) so that application of trust funds to another charitable purpose would be appropriate. If these three requirements were met, courts could modify the purposes to reflect current trends, choosing those “as near as possible” to the donor’s original intent. MARION R. FREEMONT-SMITH, \textit{supra} note 27, at 173.
\textsuperscript{238} Goodwin, \textit{Ask Not, supra note 164}, at note 107 and accompanying text. “As near as possible” is a translation of the full original French term for the doctrine, \textit{cy pres comme possible}, requiring that any modified application of funds be used for purposes as close as possible to the donor’s original intent.
impossible or impracticable” and didn’t include those considered wasteful. This gap was at issue in *In Re Estate of Buck*, described earlier.  

As previously noted, due to an unprecedented increase in value, in less than a 10 year period, the SFF (within 3 years of accepting responsibility for the Buck Trust), sought to modify the trust under the doctrine of *cy pres*, to expand its uses beyond Marin County on grounds that it was wasteful and inefficient to apply so much money to such a wealthy county as Marin. But the SFF faced a big problem - grounds for *cy pres* modification did not expressly include waste. So the SFF argued that waste was subsumed in one of the other required triggers for modification, *i.e.*, impossibility or impracticability. Unfortunately, in the view of many scholars, the court did not agree and decided against application of the *cy pres* remedy.

The SFF’s rejected waste argument in the Buck Trust case generated enormous academic commentary for years following the decision, ultimately leading to very recent reforms of model and uniform *cy pres* laws to expressly encompass waste as a basis for modification of a restricted gift’s terms. Still, for the reasons articulated in this Part, I posit that these recent *cy pres* reforms aren’t enough to insure a changed outcome in the next Buck Trust-like case.

Liberalization of the *cy pres* doctrine spurred by the Buck Trust case is evidenced by changes reflected in the current the Restatement (Third) of Trusts, Uniform Trust Code (UTC), UPMIFA, and the proposed ALI Principles of Nonprofit Organizations, herein all collectively called the “model reforms,” in that they now all include another criterion - “wasteful” - as an additional trigger for modification under the *cy pres* doctrine. But even if the reform models are adopted widely by states, it’s doubtful they’ll lead to significant curbing or prevention of ILCEE waste. First, the political barriers to *cy pres* actions are just too daunting. Second, all the model *cy pres* reforms dodge (appropriately?) the question of defining waste.

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239 *Supra* Part III.B.2.
240 *Id.*
241 *Id.*
243 Restatement (Third) of Trusts, Sec. 67.
245 UPMIFA §6.
247 Other key changes include the elimination of the requirement of general charitable intent (UTC, *supra* note 242, at§413 cmt.), or a weight of a presumption that increases with the passage of time (Restatement (Third) *supra* note 242, at §67 cmt.; Principles, *supra* note 244, § 440); and provisions permitting modification of uneconomically small restricted funds without the resort to the courts if the value is less than a stated amount (UTC, *supra* note 242, at § 414 (a) (providing a $50,000 and below trigger); UPMIFA §6 (d) (providing a $25,000 and below trigger)). Most relevant to this article, the triggers for modification now include “wastefulness” under the UTC, the Restatement and the Principles, largely in response to the Buck case.
248 *See infra* Parts IV.A.2.a. and b. discussing these political and definitional challenges, respectively.
Daunting Political Barriers to Cy Pres Actions

The legal limits of the former cy pres doctrine (which excluded wastefulness) constituted only part of the obstacles SFF faced in the Buck Trust case. Specifically, in addition to the substantive legal barriers of not having wastefulness as an express grounds for cy pres, the SFF’s efforts to modify the Buck Trust gave rise to a huge political firestorm from multiple directions. First, and most importantly, Marin residents (a wealthy political base) were vociferous in opposition to the possible diversion of the funds from Marin County.249 Further, the manager/trustees of the SFF themselves were strongly divided on the issue of whether modification was appropriate.250 And finally, the California Attorney General also opposed the modification.251 Every potential cy pres action inherently involves these politics, making even the initiation (let alone a favorable decision) of any such action, whether on traditional or new grounds that might now include wastefulness, highly unlikely. This is because these political forces emanate from hard-to-overcome regional and manager self-interests, no matter any expanded cy pres criterion to now include waste.

To elaborate, it’s important to recognize that cy pres is a proactive offensive measure as opposed to a defensive one; it requires someone to initiate action,252 or stated in the vernacular, to “rock the boat” when no one has complained. This is difficult for even the most principled. Thus, basic rules of inertia are the first to mitigate initiative for any cy pres action not motivated by impossibility or impracticability. These traditional standards are unarguably significantly more urgent and objectively quantifiable, or at a minimum, more problematic, than the new grounds of wastefulness added in the model reforms. Faced with impossibility or significant impracticability of implementing a restricted gift under traditional cy pres, managers of a charity-donee of a restricted gift have little choice but to seek cy pres. Otherwise, the restricted gift will likely go unused. But a cy pres claim based on the new grounds of wastefulness involves application of a much more conflict-ridden and subjective standard. No one is likely to complain because, unlike the impossible or impractical situation, the funds won’t be left fallow and unused. In fact, if wastefulness isn’t argued, the target recipients of the charity will be lavishly served. Even more significantly, any litigation on the basis of wastefulness also involves a value-judgment about how much is too much, something variable with every individual. So there likely will always be patrons, managers and overseers of a charity who have a different value-judgment about what is wasteful who will oppose a cy pres action based on a wastefulness claim.

Although state Attorneys General (AGs) and managers (e.g., directors and trustees) of charities are typically the only parties with standing to bring a cy pres action,253 both groups are strongly influenced by public opinion. AGs are elected

249 FISHMAN & SCHWARZ, supra note 25,109-110.
250 Simon, supra note 193 at 642.
251 FISHMAN & SCHWARZ, supra note 25,109-110.
252 See MARION R. FREEMONT-SMITH, supra note 27, at 174 (noting that to invoke the cy pres doctrine, the trustees or attorney general must apply to the court for permission to modify the trust, typically suggesting a plan for the court to adopt).
253 There are limited situations where donors or beneficiaries can be granted standing because of unique interests, but the managers of charities (i.e., directors, trustees, and officers, depending on a charity’s entity form) have primary governance authority, with AGs being given oversight authority to monitor charities on behalf of the public since charities are partially financed by the government and there are no shareholders
officials, charged with protecting the public, who will not be re-elected unless they’re attuned to public sentiment. Correlatively, charity managers are very aware that the reputation of their charity and the strength of its halo are crucial to its viability, so they don’t want to unnecessarily sully the charity’s image by taking unpopular positions.

Public opposition is likely to come from the residents of the region where the restricted gift is to be spent. Something akin to a “company town” mentality takes over. Like with the Buck Trust case, a type of restricted gift that may cause ILCEE waste involves restrictions requiring narrow geographical application of funds. In these situations, a state AG, as a regional representative, has absolutely no political incentive to initiate a cy pres action that might send monies in a restricted charitable fund outside the geographical area to which it has been expressly dedicated, even if such application might be considered by some as wasteful. No matter the extent of the “some” who might consider the gift wasteful, there’ll definitely be other political constituents (likely in the majority) who’re primary or indirect potential beneficiaries of the restricted use who’ll probably view the gift as a right, rather than a privilege, granted by the donor. That’s why Marin County residents fought use of Buck Trust funds outside of Marin and it’s likely also why the AG opposed the Buck Trust modification. By seeking use modification and taking what local stakeholders see as “their” money for their community needs, AGs would make enemies of potential voters who might otherwise support them if they simply just took a protective status quo view of geographically restricted gifts. Very few people, let alone AGs, would do this, given no political downside to the status quo.

Additionally, AGs are usually overwhelmed with more pressing political matters and typically only intervene in charitable matters when issues of potential illegality arise. Not only does the potential for ILCEE waste not involve illegality, but the application of restricted gifts as directed by a donor, even if wasteful, represents the height of legality because such application represents unfaltering adherence to a manager’s fiduciary duty of obedience to donors and her charity’s mission. So even if there’s no public opposition to a cy pres action on the grounds of wastefulness, an AG is unlikely to take valuable time and resources to pursue or support such an action.

But what about the other principal group with standing - the managers of the charity gifted the potentially wasteful restricted fund? If, for some unique set of reasons, managers very untypically find themselves in a situation where they have limited concern about a populace backlash that might damage the reputation of the charity, surely these fiduciaries will seek cy pres for a gift that might result in ILCEE waste? I submit this is still unlikely. The reason is the power of money. Or more pointedly in the charitable

or similar equity-holders who can bring actions such as with for-profit entities. See generally MARION R. FREEMONT-SMITH, supra note 27, at 324-330.

254 See supra Part III. A. 2.
255 See supra notes 249-250 and accompanying text regarding resistance by residents and the AG.
256 Manny, supra note 18, at 758.
257 Oversight responsibilities of AGs in non-charitable arenas are alone significant. So, most AGs focus on a few areas of priority regarding charities, like fundraising transparency/disclosures by nonprofits, and rely on whistle-blowers or political will to dictate their focus on other charitable matters. See generally Terri Lynn Helge, Policing the Good Guys: Regulation of the Charitable Sector Through a Federal Charity Oversight Board, forthcoming, 29 CORNELL JOURNAL OF LAW AND PUBLIC POLICY, No. 1 (2009), available at http://papers.ssrn.com/sol3/papers.cfm?abstract_id=1511796, last visited 2/21/2010; James J. Fishman, Improving Charitable Accountability, 62 MARYLAND LAW REVIEW 218, 262-263 (2003); Manny, supra note 18, at 758.
context, the power one has when she can decide how to distribute other people’s money. Managers of restricted charitable funds enjoy significant political influence and power because they can direct money to people who want it and seek it. Thus, it’s in a manager’s self-interest to retain that power and influence. A cy pres action for a fund’s broader application could well be counter to that goal. This is because restricted gift managers who seek cy pres to broaden application of the restricted gifts, might actually divert funds from their control to other managers/people.

If managers decide to seek cy pres on the grounds of wastefulness, then in addition to the bringing of a successful cy pres action to expand the geographic limits of the restricted fund, the charity would probably also have to amend its charter documents to expand its purposes beyond its prior geographic limits and to allow grants to other entities.

Given the above arguments about the political pressures against initiation of any cy pres action for wastefulness, the fact that charity managers are the most likely initiators of any such action is already indicative of the inadequacy of this remedy. Choosing between broader altruism over personal political influence or, more fundamentally for some managers, political survival goes against self-interest. Extremely few people initiate action against their own self-interests. This is even more the case when both the cy pres and status quo positions regarding a restricted gift in the context of a wastefulness argument will each still serve charity (as broadly defined). The natural instinct of individuals in such a relatively moral equilibrium situation will be one of self-interest, allowing political influences to probably prevail to prevent or significantly curb the likelihood of any fund manager’s cy pres action. Thus most managers of restricted funds will lack any motivation to bring a cy pres action to expand its uses, even if applicable state law grounds for cy pres might now include wastefulness. The charity managers still will likely view the cy pres uses and the status quo uses as both serving charity, though maybe not optimally or efficiently.

b. Yet Again, the Obstacle of Defining Waste Intrudes

Let’s assume the political and other self-interest barriers to initiation of a cy pres action on the basis of wastefulness could somehow be overcome. The likelihood of success on wastefulness grounds is still very doubtful. This is because all the model cy pres reforms dodge (appropriately?) the question of defining waste. The Restatement (Third) Trusts offers a description of a situation of waste by stating that it arises when “the amount of property held in the trust exceeds what is needed for the particular charitable purpose to such an extent that the continued expenditure of all of the funds for that purpose, although possible to do so, would be wasteful.” [Emphasis added] As further clarification, the Restatement simply states that: “The term ‘wasteful’ is used here neither in the sense of common-law waste nor to suggest that a lesser standard of merely

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258 The scope of influence depends on the size and reach of the funds over which they have oversight. If it’s a regional fund, they have local influence. If it’s a global fund, the influence is global.

259 Restatement (Third) of Trusts, supra note 243, at § 67 cmt. c.(1). Another description in the comments provides a somewhat different angle which may be more confusing rather than useful. It states: “if a testator devises property in trust to establish and maintain an institution of a particular type but a similar institution already exists and is sufficiently effective that the testator’s plan would serve no useful purpose, the intended purpose will not be enforced.” Id.
'better use' will suffice.” Although this comment confirms my earlier arguments about the waste doctrine’s limited focus on dissipatory rather than extravagant type waste, it’s otherwise unhelpful. The gist of these comments seems to be that the funds allocated would be significantly excessive for the purpose. But this merely begs the question of what’s considered significant excess by most people. It still leaves determination of wastefulness to very subjective value-judgments, as previously noted. In light of this fact, it’s probable that a court will favor original donor-intent and keep the status quo as the compromise value-judgment that should prevail except in very egregious situations. This is a very high standard, unlikely to be met in the typical restricted gift situation that might lead to ILCEE waste. The Buck Trust case was unique in this regard. At the time of the case, there was a rare coalescence of facts that garnered some significant consensus that application of the Buck Trust restrictions would be wasteful, such that it emboldened the SFF managers to bring the cy pres action despite the doctrine’s shortcomings to expressly include wastefulness as grounds for modification. Also, I don’t believe the managers of SFF anticipated the political firestorm their action would generate. Rather, in terms of 1970’s-80’s values, the Buck Trust was incontestably extremely wealthy by any relative measure and the trust beneficiaries who were to benefit from this enormous wealth had the highest per capita incomes in the state. Thus, we had a situation where incontestable wealth was getting the benefit of more incontestable wealth. No wonder the SFF managers were motivated to pursue cy pres despite the doctrines shortcomings. But in situations involving trusts of lesser relative values and/or more needy beneficiaries, it can be rough going to argue that large, even exorbitant application of trust dollars to restricted purposes reaches the level of wastefulness. This task is exponentially harder when the issue of wastefulness (or not) is being examined in the abstract at the state trust and corporate law level, without an anchoring to a reference point that I posit the tax law can provide. But we must first examine whether the current tax law rules are already adequate to address the potential of ILCEE waste. As I’ve just argued and stated in this section relative to the non-tax laws and rules, I think not.

B. Current Federal Tax Law Remedies Also Inadequate

1. Overview

Current Federal tax-exemption laws contain two broad standards and two specific rules that could potentially address exorbitant-type expenditure. Unfortunately, as currently articulated and constructed, each is limited in application to punishing illegal expenditures, rather than curbing or preventing legal, but inappropriate, exorbitant type expenditures involved in ILCEE waste. That’s why these tax rules impose penalties

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260 See supra Part IV.A.1.a.
261 This is consistent with a statement made by the Reporter for the UTC in commenting on the “wasteful” trigger added to UTC Sec. 413(a) that, “[c]ases of waste normally involve situations where the funds allocated to the particular charitable scheme far exceed what is needed.” See, David M. English, The Uniform Trust Code (2000): Significant Provisions and Policy Issues, 67 Mo. L. Rev. 143, at n.164 (2002).
262 See supra Parts II.C., IV.A.1.c. and 2.b.
263 See MARION R. FREEMONT-SMITH, supra note 27, at 182 (noting the case presented the issue of treatment of surplus funds “at its extreme.”).
(rather than the tax I propose) in the form of either intermediate sanctions or complete loss of exemption by the charity. Moreover, they each are limited in application to specific and narrow types of expenditures, which even if made legal, would not preempt many types of ILCEE waste. The tax-exemption rules I speak of are the general IRC tax-exemption law rules barring: 1) any (including de minimus) “private inurement;” 2) more than incidental non-inurement type “private benefit;” 3) “excess benefit transactions” under IRC §4958; and 4) “expenditures for non-charitable purposes” under IRC §4945(d)(5). The first three are applicable to all charities but the fourth is only applicable to private foundations. Accordingly, I begin by discussing the first three.

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264 IRC § 501(c) (3). Under § 501(c) (3) a charity can’t allow any of its net earnings to inure to the benefit of any private shareholder or individual. “Private shareholders and individuals are the ‘insiders’ of an exempt organization, its board members, officers and managers, the ones who control the organization.” CAFARDI & CHERRY, supra note 107, at 70. So loosely stated, the inurement proscription generally prevents the flow of assets of a charity away from the charity for non-charitable purposes to someone with substantial influence over the charity. Manny, supra note 18, at note 6. “The proscription …comes into effect only when benefits conferred on the individual are not commensurate with the services he or she provides to the charity. Thus it is not an absolute ban . . .; rather it is a standard based on reasonableness that can be substantiated by reference to the terms of an arm’s length transaction.” MARION R. FREEMONT-SMITH, supra note 27, at 248-249. So, reasonable compensation (as measured by market standards) and other compensatory benefits are permitted under the private inurement rules. Id.

265 “Private benefit involves a benefit to private as opposed to public interests. An organization is not operated for exempt purposes unless it serves a public rather than a private interest.” CAFARDI & CHERRY, supra note 107, at 70. “To determine if there is private benefit, the courts examine the facts to establish whether the individuals benefiting from the activities of an exempt organization are too narrow, too small, or too limited a group.” Id., at 69. Most charitable endeavors involve some private benefit to the beneficiaries they service. So unlike the prohibition against any private inurement, the private benefit rules only constrain private benefit that is more than incidental benefit.

266 IRC § 4948(a)(1) (defining an excess benefit transaction as “any transaction in which an economic benefit is provided by an applicable tax-exempt organization directly or indirectly to or for the use of any disqualified person if the value of the economic benefit provided exceeds the value of the consideration (including the performance of services) received for providing such benefit.”) The excess benefit transaction rules were enacted to provide a less severe IRS disciplinary action than loss of tax-exemption for charities which might (possibly inadvertently) violate the private inurement rules. As such, their focus is on transactions involving people who might be insiders (called “disqualified persons” in the excess benefit regime). Manny, supra note 18, at 736.

267 IRC 4945(d) imposes an excise tax on private foundations for what it terms as “taxable expenditure.” There are 5 categories of taxable expenditures, including the carrying on of propaganda or attempting to influence legislation, influencing elections and carrying on voter registration, travel and study grants to individuals unless made pursuant to certain specified non-discriminatory rules, and grants to organizations unless they are subject to expenditure responsibility accountability. IRC § 4945(d). The fifth expenditure category sanctioned as “taxable” is in the nature of a “catch-all.” MARION R. FREEMONT-SMITH, supra note 27, at 282-283. “In a catch-all phrase at the end of IRC Section 4945(d), Congress imposes [an excise] tax on any amount paid or incurred by a private foundation for ‘any purpose other than one specified in section 170(c)(2)(B).’” CAFARDI & CHERRY, supra note 107, at 327. The referenced IRC §170 subsection essentially includes the entire IRC §501 (c)(3) list except public safety testing organizations, and denotes nonprofits eligible to attract tax deductible gifts (i.e., called charities herein). Id. See also MARION R. FREEMONT-SMITH, supra note 27, 282-283 (characterizing elements of IRC § 4945 as “overkill”).
2. Constraints of the First 3 Tax Rules – Private Inurement, Private Benefit and Excess Benefit Transactions

Private inurement and private benefit tax rules are very related, but are directed at different targets. Private inurement prohibitions are meant to preempt nonprofit “insiders” such as managers, major donors, and the like from receiving any benefits that aren’t in service of the charity’s mission. Essentially the no-inurement rules are targeted towards people in control of managing charities who might attempt disguised violations of the non-distribution constraint via extravagant benefits to themselves, like unreasonable salary, a loan or use of a company car for personal needs. In contrast, private benefit rules seek to ensure that charities primarily serve a genuine public rather than private interest, without unduly benefiting private citizens (i.e., non-insiders) who might not need subsidized assistance.

For example, as to private inurement, if payments made to charity insiders as either employment compensation/salary or for transactions between an insider and a charity (like rental payments for lease of a building or equipment, or repayments of a loan to an insider, etc.) exceed reasonable market rates, then there’ll likely be insider private inurement sufficient to justify the charity’s loss of tax exemption. The excessive payment means there wasn’t equal exchange of value for the payments, or, as typically referenced, no quid pro quo; the payment wasn’t compensation for, or in exchange for, something of equivalent value. So, private inurement rules prevent a charity from using donated, deductible and tax-exempt, dollars to give a controlling insider an exorbitant salary or other benefit in clear excess of market rates for her services as a ruse to distribute “profit” to her as though she were a shareholder. The smallest violation of private inurement rules could lead to a charity’s loss of exemption. It’s a hair-trigger rule.

In contrast, the no-more-than-incidental private benefit rule is meant to prevent charities from structuring payments or mission in ways that might unduly benefit individual “outsiders” (i.e., third parties who don’t have control or significant influence over a charity’s governance to qualify them as insiders) more than the community. In essence the no-more-than-incidental private benefit rule is another check on whether a charity is primarily serving tax-exempt purposes under Sec. 501(c)(3). Since most charities benefit private individuals in some way, through free food, shelter, or other reduced cost services to particular private individuals, typically low-income people. The question is whether these private benefits reach a point where the charity is considered as serving mostly private versus public/community matters. So in contrast to the hair trigger rule of private inurement, private benefit

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268 This is also captured in what’s called the “nondistribution constraint” at both the state and federal levels of laws. This nondistribution constraint (a term coined by Prof. Henry Hansmann) is the fundamental dividing line between for-profit and nonprofit entities. Nonprofit organizations must be organized and operated to prevent people in control of the nonprofit from receiving a distribution of profits via payments that might be likened to disguised dividends to shareholders/controllers in the for-profit arena. See generally, Hansmann, *The Role*, supra note 53, at 840; Lewis, *supra* note 25, at 1780-1781; FISHMAN & SCHWARZ, *supra* note 25, at 3.

269 See *supra* note 268.

270 See *supra* notes 38, 53-55, and 265 and accompanying text.

271 See *supra* note 264; Manny, *supra* note 18, at 745.

272 Most charities benefit private individuals in some way, through free food, shelter, or other reduced cost services to particular private individuals, typically low-income people. The question is whether these private benefits reach a point where the charity is considered as serving mostly private versus public/community matters. So in contrast to the hair trigger rule of private inurement, private benefit
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rule and permits “incidental” private benefit. It’s only when such private benefit becomes more than incidental relative to the public/community benefit received that the private benefit doctrine imposes punishment. So, for example, when “outsiders” are paid unreasonable amounts for services or products provided, the private benefit doctrine penalizes this.\(^{273}\)

The third tax-exemption rule, the IRC §4958 intermediate sanction rule against excess benefit transactions is intended as a more objective rule to serve as a less severe counter-part to the general no-private-inurement rule. Because Congress considered the hair trigger standard of absolutely no-private-inurement-or-suffer-loss-of-exemption too onerous, they enacted a number of intermediate standards, including those of §4958, to impose excise tax penalties on a charity, rather than the draconian sanction of yanking its exemption, for what are called “excess benefit transactions” involving insiders.\(^{274}\)

All three of the above tax rules involve significant complexities that, though interesting in their details and applications, don’t necessitate full elaboration in this article. This is because the scope of each is clearly conceptually inadequate to the task of ILCEE waste prevention or, more relevantly, outside the definition of ILCEE waste.

First, there’s an obvious procedural draw-back to these three laws in terms of ILCEE waste mitigation; none provides a uniform solution for extravagant expenditures paid to both insiders and outsiders for services or goods. So any ILCEE waste claim brought by an AG or the IRS or other party with standing\(^{275}\) would have to first identify which law applies, and in the case of cross-over waste situations involving both insiders and outsiders, would have to involve the unique criteria of multiple laws.

Second, and more importantly, all three rules have a commonality that dooms their application to ILCEE waste situations; they all target expenditures or purposes that either exceed market rates or excessively benefit private interests over community interest. In fact, by definition,\(^{276}\) ILCEE waste occurs within market confines and predominant community benefit. Problems of ILCEE waste occur because of inappropriate extravagance in the service of community benefit, and not because of excess market payments to insiders, or any beyond-incidental benefits to private individuals. Rather, with ILCEE waste, too much is paid for the level of community

Analysis typically employs a balancing test to see if a charity’s activities are serving private benefit more than community benefit. See also supra notes 38, 53-55, 265 and accompanying text.

Another example of a private benefit problem might arise if a charity decided to start providing reduced cost high-end consumer products to low-income people. Because these consumer products are high-end items, rather than basic necessities, the community benefit in this scenario is virtually non-existent and indistinguishable from, and also potentially in competition with, the market forces of a capitalist society. If the charity applied to the IRS for exemption on this basis, it would be undoubtedly denied. But many charities with organizational documents that comply with exemption standards may deviate from course and benefit private more than community purposes years after they form. The no-substantial-private-benefit standard (like the no private-inurement rule) will apply no matter when the violation occurs. All charities must be both organized and operated to comply with Sec. 501(c) (3) at all times. See, e.g, MARION R. FREEMONT-SMITH, supra note 27, at 246-248. See also supra note 266 and accompanying text.

Typically only the state AG and the managers of a charity have standing, but exceptions apply to allow other interested parties to intervene or bring an action under certain circumstances. See generally MARION R. FREEMONT-SMITH, supra note 27, at 324-338.

See supra Part I.A.1.
value received (even though this level of community value may still far exceed any excess private benefit concerns).

For example, suppose a charity building a new facility financed by an extremely rich restrictive fund for that purpose decides to use a very expensive exterior treatment on the building to make it “pop,” or to use a top-of-the-line “green” flooring tile that’s environmentally experimental and unproven but still at least futuristically aesthetic, all because the restricted gift’s budget not only supports, but may even mandate, such expenditures. The costs of the exterior building treatment or top-of-the-line tile actually do command the market rates the charity pays. People (insiders or outsiders) are not being over-paid for the products and services offered. In fact, they may actually be being underpaid in terms of market rates. So there’s no violation of the private inurement or excess-benefit transaction rules. In addition, as long as the building will significantly serve the community in terms of its mission relative to the private benefit provided, there’s generally no more-than-incident private benefit under the private benefit rule.

Similarly, if a nonprofit symphony has a large endowment for a new performance hall and using wood from the bottom of the ocean for the new hall is desirable because that wood has unique acoustical ability, the symphony can pay for that wood and not be subject to sanction despite the private inurement, private benefit and excess benefit rules. The wood will cost significantly more that regular acoustical engineering. But that cost still has the relative weight of the community’s cultural benefit to the private benefit of the unique wood suppliers on its side, i.e., the capturing of a more true symphonic sound for a larger capacity hall of attendees. Moreover, nobody is being compensated more than their efforts and the quality of their product is worth in terms of market values.

To my mind, however, when government subsidies are at issue the question isn’t whether no-more-than-market-rates are paid (i.e., whether Americans are fleeced for exorbitant charges given market rates) or whether the community benefit is substantial. Rather, the core question is whether there’s enough community benefit to justify the amount of governmental subsidy. This point addresses an entirely different standard than that addressed by the first three tax rules discussed above. The fact that a charity’s expenditures for significant community benefits are within market rates doesn’t address the exorbitance issues. What the median-voter is willing to spend on a government-financed project might not be the top-of-the-line market rate for such project, even if the project provides significant community benefit. This point conveniently leads to discussion of the fourth IRC tax rule that might be of assistance to the ILCEE waste problem - IRC § 4945(d) (5).

3. Private Foundation Expenses for Non-Charitable Purposes – Sec. 4945 (d) (5)

IRC Sec. 4945(d) imposes excise taxes on certain expenditures, called “taxable expenditures,” typically allowed by public charities, but that are absolutely disfavored if made by private foundations because of their typically closely-controlled structure. IRC § 4945(d) taxable expenditures include such things as the carrying on of propaganda or attempting to influence legislation and grants to individuals or non-public charities unless certain standards are met. More pointedly in terms of the particular focus of this

277 See supra note 267 and accompanying text.
278 See supra Part III. D.3.(discussing private foundations).
article, IRC §4945(d) includes a catch-all phrase in subsection (5) of the section to prohibit “any amount paid or incurred by a private foundation . . . for any purpose other than one specified in section 170(c)(2)(B),” or in the vernacular, for “non-charitable purposes.” So, at an initial level, subsection (5) of Sec. 4945 (d) is a lot like the private benefit rule (generally applicable to all charities) in that it appears to prohibit payments that are not for public benefit. But unlike the regulations under the private benefit rule, regulations under Section 4945(d) (5) expressly cite “unreasonable” administrative expenses, including “compensation, consultant fees and other fees for services rendered,” as matters not for charitable purposes. Accordingly, at least on the face of this wording, this regulation has potential application to exorbitant expenditures amounting to ILCEE waste. Unfortunately, a closer examination disappoints. Even if my suggested interpretation is given to “unreasonableness” to henceforth include extravagant expenditures amounting to ILCEE waste, the Sec. 4945 (d) (5) catch-all provision is fraught with four additional problems.

First, the IRS regulations under this subsection seem to only address unreasonable administrative expenses for services, with no specific reference to expenses for products. It’s imperative that unreasonable, exorbitant payments for products, as well as services, also be included in any waste-focused rule. Otherwise, there’re no limits on any building project or any equipment needs.

Second, and more problematically, there is a broad “good faith” exception in Sec. 4945(d)(5) that allows what would otherwise be taxable expenditures if the private foundation can “demonstrate that they were paid in the good faith belief that they were reasonable and were consistent with ordinary business care and prudence.” This basically allows any payment that can be supported by market rates, even when market rates may not always be the appropriate standard for government subsidies.

Third, Sec. 4945(d)(5) only applies to private foundations, leaving out the potential for ILCEE waste by public charities holding excessive restricted gifts as either current operating funds or endowment funds.

Fourth, and most importantly, except for the “good faith” requirement, the broad charitable purpose language of the statute is problematic because it isn’t anchored to any standard. Rather, the language implies an abstract, unanchored public benefit standard, independent of any balancing against a fiscal responsibility standard. This abstract standard is so vague that if a charity has even a semblance that its expenditures are for a charitable purpose, they likely will be allowed, even though many might consider them extremely extravagant.

C. Summary of the Current Laws

In summary, current anti-exorbitance rules applicable to charities have serious limitations that make them all ineffective potential weapons against ILCEE waste. The common-law doctrine against waste focuses on dissipatory rather than extravagant type

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279 See supra notes 130 and 267 for the listing of entities covered (all except public safety testing).
280 26 CFR Sec. 53.4945-6(b)(2).
281 Id.
282 26 CFR Sec. 53.4945-6(b)(2).
283 See infra Part V.D.1. (discussing market versus government rates).
284 See supra Part III.D.2. (discussing endowment funds).
waste and typically requires a conflict of interest between concurrent or sequential owners, which is not applicable in the charitable context.

On the other hand, the new wastefulness grounds of the reform laws added to the common-law *cy pres* remedy require a generally unmandated and regionally unwelcome (though potentially prudent and efficient) action by charity managers that’s highly unlikely to even be initiated given the potential for political backlash and the self-interest of managers. Current tax-exemption rules are equally inadequate in preventing or curbing ILCEE waste. Most are focused only on prohibiting excess “market-rate” payments, which could be phenomenally high, rather than more moderate rate criteria that median-voters might deem appropriate for government subsidized activities. Additionally, tax-exemption rules requiring charities to serve community/public benefit are either tested against a standard of too much private benefit, which isn’t an ILCEE waste situation problem, or against an abstract standard of public benefit that involves no weighing of whether too much is paid given the amount and nature of the public benefit received. In other words, as long as some public benefit exists (and any private benefit is merely incidental), the current tax rules do nothing to curb how much is spent on the provision of that public benefit within market rates.

The final Part below argues for a more objective standard via a tax that eliminates the short-comings of current laws.

V. A PROPOSED TAX ON EXTREMELY LAVISH CHARITABLE EXPENDITURES

A. Why a Tax, Rather than Other Options, Makes Sense

1. Balancing Reform Needs versus Reform Harm Concerns

So it appears the sky’s the limit in terms of how much may be paid for services or products by charities using government-subsidized dollars. As long as the primarily-for-charitable-purposes criteria is met, even an extremely exorbitant charitable expenditure will likely be allowable under current laws without any sanction or threat of government subsidy loss. And restricted gifts increase the potential for such exorbitance. As noted by Iris Goodwin, “[C]harities operate under a woefully inadequate set of laws…with respect to …restricted…gifts. The law here does little to guide (and when necessary, police) charities in their stewarding of such gifts over time.” For these reasons some type of anti-exorbitance law for charities is warranted and why I’ve spent most of this article making this case. But now is also the time to acknowledge the full impact of all the positives about nonprofits, most of which have been discussed earlier, as they relate to an ILCEE solution, and the harm that could be done to these positives if care isn’t taken in the design of any new tax.

These positives aggregate to make an extremely significant counter-veiling point, to wit: any anti-exorbitance law could have severe unintended chilling effects on donor generosity and on the accomplishment of very important charitable good. These

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285 This is the title phrase used by Professor Jill S. Manny in an article discussing salaries paid to charity executives. Manny, *supra* note 18.
286 Goodwin, *Ask Not, supra* note 164, at 76.
287 *Supra* Parts I.B.2.b. and III. A.1.(discussing the qualitative aspects and pluralism, respectively).
288 See Schizer, *supra* note 53, at Part III.
possible chilling effects are sufficiently significant that charity advocates have a forceful argument against any anti-exorbitance law at all. They’ll accurately observe that the incidence of ILCEE waste may be frequent in abstract terms, but is infrequent relative to the broad universe of charities that are under-funded rather than over-funded. This coupled with the fact that any anti-exorbitance law is highly likely to be over-inclusive means such a law may capture too many of the good for too few of the bad. Given the relatively low incidence of ILCEE waste, this may not be a societal cost worth paying in the minds of many.

I posit, however, that the solution to these conflicting concerns isn’t to do nothing. Instead, the conflict between curing the harm and harming the good can and should be balanced by a well-designed tax solution. In fact, it’s precisely these conflicting concerns that engender my belief that a tax solution is superior to other anti-exorbitance law solutions. For the reasons articulated in this Part, a well-designed tax on ILCEE waste (as opposed to doing nothing, expanding state common-law waste or trust law or imposing onerous tax-exemption sanctions and penalties) achieves the best compromise.

2. Subject vs. Amount Appropriateness

Remember, ILCEE waste is by definition currently legal, including not being subject to penalty sanctions. Although the first letter of the acronym stands for “inappropriate,” it refers to inappropriateness as a matter of taxpayer/government subsidy - not inappropriateness as a general abstract standard. Expenditures could be totally subject-appropriate as a matter of charitable, community benefit, but may be amount-inappropriate as a matter of government subsidy. So ILCEE waste situations do not necessarily involve a community benefit failing which should result in a total loss of exemption for a charity or a severe excise penalty for wrong-doing. In fact, ILCEE “waste” may often serve community benefit. Moreover, the public/community benefit of a given charity’s project could so exceed basic expectations as to take community benefit to a higher plain of consciousness, even setting a new standard of excellence that may eventually become a public/community benefit norm.

For these reasons, it’s vitally important to not necessarily associate extravagant expenditure with wrong-doing. True, exorbitant and lavish expenditures may lead to garishness, unnecessary opulence in facilities or physical appointments and obscene (though still reasonable, given market rates) salaries or benefits for charity executives who don’t deserve them. On the other hand, a charity’s venture may well be very commendable as an abstract matter, even when it could so exceed expense expectations for a government subsidized endeavor as to be considered lavish and wasteful as a use of tax dollars in the context of the times. The current tax law options of either yanking the entire tax-exempt status of a charity or imposing severe intermediate sanctions significantly stigmatize charities for wrong-doing. A tax designed to provide amount parameters on the use of subsidized dollars would be neutral and non-judgmental about the expense decision. Wealthy charities would and should still be absolutely free to decide to spend whatever they think appropriate for salaries, buildings, projects, etc. (subject of course to the legal parameters applicable to charities) if they think the results

289 See supra note 78 and accompanying text.
290 Supra Part I.A.1.
will be worth the cost. This would not only respect a charity’s autonomy but would also honor donor intent and generosity (and possibly help shape donor conduct) in the case of restricted gifts. The only difference would be that any such decision would not be subsidized by taxpayers.

3. Anchoring Wastefulness to an Economic Reference

One of the primary reasons a tax solution is a good vehicle for addressing ILCEE is that it’s exponentially harder to examine an issue of charitable wastefulness (or not) in the abstract at the state trust and corporate law level, without a weighing of a *quid pro quo* for a particular state law status or benefit (other than the right to perpetual existence). A tax solution, compared to a generalized anti-exorbitance rule, can preserve the distinction between abstract notions of wastefulness versus wastefulness as a matter of governmental priorities. An abstract perspective is what’s presented by the simple common-law waste or *cy pres* contexts or by tax-exemption rules that threaten the entire tax-exemption status of a charity or impose severe penalties in lieu of taking away the exemption. But when the issue of wastefulness-or-not is anchored by reference to a particular *economic* privilege given by local, state and federal governments as a matter of tax status, then the economic benefits and burdens of degrees of wastefulness are easier to grapple with than in a totally abstract context.

Citizens or charities receiving tax-privileged benefits, and even more pointedly, citizens or charities not receiving these benefits, can at least begin to have some referential basis for “wastefulness” if the expenditures are being considered in a context of broad economic trade-offs rather than more abstract notions of community benefit. Community benefit is hard to quantify in dollars and cents, which is why a pure *quid pro quo* analysis is unachievable. But this task becomes significantly easier (though still difficult) when the question is limited to whether to simply tax only the excess (i.e., potentially wasteful) amounts deemed inappropriate for government largess.

4. An ILCEE Tax May Also Spur *Cy Pres* Actions, Etc.

A significant added benefit of an ILCEE tax is that the threat of tax liability will bolster wastefulness arguments in any *cy pres* action that might actually be brought at the state level. So an ILCEE tax potential could actually operate as an incentive for charity managers to bring a *cy pres* action. Additionally, an ILCEE tax also could operate to silence or mitigate political opposition to any *cy pres* action for wastefulness. Most significantly, the potential of an ILCEE tax could definitely increase the likelihood of success of a *cy pres* action based on wastefulness since the potential imposition of the tax may be sufficiently burdensome to argue against the benefit of the extravagance in some

291 How to honor donor intent in the case of restricted gifts has been the focus of a lot of recent scholarship. See, e.g., Goodwin, *Ask Not*, supra note 164. “While innovation and diversity spring from many sources in the charitable arena, it is in donors, as they condition their gifts with restrictive language, that innovation and diversity find their guarantee. Accordingly, any procedural solution to the problem of restricted gifts must continue to accord donor preference as expressed in the language of a grant a privileged place in the law.” *Id.*, at 122. Also see Eason, *supra* note 164, at 693-694; Brody & Tyler, *supra* note 129; Schizer, *supra* note 53, at Part III.

292 See infra Part V. A.4.

293 See *supra* note 154 an accompanying text; Brody & Tyler, *supra* note 129, at 57.
relatively limited funding situations. Even more proactively, the potential for an ILCEE
tax could shape the framing of donor-restricted gifts by encouraging donors to allow
modification of restricted gifts if the tax is implicated. Additionally, as extravagant type
wastefulness, or in the words of Professor McCaffery (when discussing the common-law
waste doctrine) “non-urgent expenditures,” become more and more part of the general
discourse of wastefulness, the doctrine of waste may also become a more effective
vehicle for state-law constraint of wasteful activities.

B. The Doctrinal Rationale for an ILCEE Tax

The rationale for an ILCEE tax is that expenditures of excess dollars serve
insufficient added public/community benefit to be a “charitable” activity worthy of
government subsidy within the meaning of Sec. 501(c)(3). In this regard, the
justification for a waste tax has similar grounding to the current no-more-than-incidental
private benefit rules and the Sec. 4945 (d) (5) excise tax on private foundations for
expenses for non-charitable purposes. But these latter rules currently only apply when
private benefit is seen as outweighing community benefit to the point where it’s no longer
incidental. They focus on the private benefits given to individuals. I believe the private
benefit doctrine should be expanded to incorporate a broad governmental cost-benefit
analysis component that articulates the notion that insufficient public benefit relative to
governmental cost is also a type of private benefit, even if the public benefit is still
substantial relative to private benefit. When expenditures reach a point that there’s no
way they would have been approved as an appropriate use of government funds if they’d
been part of an express grant (rather than tax expenditure) funding, then there’s a
collective societal private benefit that is inappropriate for government subsidy. In other
words the public benefit being provided in exchange for the government burden of
subsidy being carried becomes questionable as a matter of taxpayer financing. Such a
cost-benefit component to the private benefit doctrine could provide all the justification
necessary for an ILCEE tax. The tax would theoretically apply when government funding
has reached a clear point of diminishing returns, in cost-benefit terms, relative to the
additional public benefit being received.

Even Professor John D. Columbo, who in a thoughtful 2006 article admits he’s
one of the strongest critics of the current, sometimes amorphous “private benefit”
doctrine as currently articulated by the IRS, has offered waste or, in his words a “failure
to conserve” analysis as a principled underpinning and core justification for a limited
private benefit doctrine. Professor Columbo primarily examines the private benefit

294 McCaffery, Waste?, supra note 152.
295 Another approach might be to limit deductions by donors under IRC § 170 to charities that are over-
funded. See Buckles, supra note 186 (discussing such a limit to deal with over-funding of disaster-relief,
mass appeal situations). But situations where over-funded charities continue to receive charitable
contributions for the same purposes are probably limited to the mass appeals cases. Since contributions are
likely to stop after appeal response levels are revealed in the news (although admittedly after some lag-time
that can give rise to more overfunding), the incidence of over-funding is sufficiently contained as to not
warrant further complicating IRC § 170. In addition, capping deductions for this limited context doesn’t
deal with larger incidences of potential ILCEE waste and could unduly chill and reduce donations.
296 See supra Part IV.C.2.(discussing private benefit) and Part IV.C.3.(discussing IRC § 4945(d)(5)).
298 Id. at 1085
doctrine in the context of applying it to third-party payments between the nonprofit and for-profit entities and individuals. Even as a critic of the IRS’s use of the private benefit doctrine as a way of examining all economic benefits that flow from a nonprofit to a for-profit entity or individual to find some cumulative disabling level, Professor Columbo posits that a justification for a separate concept of private benefit is to illuminate and articulate “the failure to conserve charitable assets for the benefit of the charitable class by entering into transactions that cause an unnecessary outflow of assets to non-charitable interests.”

Consistent with the arguments made in this article, Professor Columbo maintains that expenditures by nonprofits that exceed what he terms as “core services” wastes “assets that should otherwise be used for charitable services – in effect, the charity is shifting some of the economic value from the various tax benefits we confer on exempt organizations (exemptions, charitable contributions deduction, etc.) away from charitable services.”

In essence, states Professor Columbo, “the tax-exemption is being used to fund the profit-margin necessarily paid to for-profit contractors as opposed to a direct service model where presumably that profit-margin would be ‘saved’ by the nonprofit and used instead to provide expanded services to the charitable class.” I expand and extrapolate on this thought to note that inappropriate private benefit in the sense of Colombo’s “failure to conserve” point also is found even when a charity is adhering to a direct service model if the services being provided are excessive and luxurious. In such instance, tax-exemption is funding the additional salaries of the employees providing the excessive services.

For the above reasons, the fundamentals of the private benefit doctrine offer ample room for justification of an ILCEE tax. All that’s needed is for the IRS to more fully articulate the private benefit doctrine in its regulatory interpretations of IRC § 501(c)(3) to include a diminishing public benefit component, including a failure to conserve aspect.

C. The Hardest Part: Designing the Tax

The above section presented reasons why an ILCEE tax is the best vehicle for an anti-exorbitance law and a doctrinal basis for such a tax. This section addresses considerations I believe must take precedence in designing such a tax.

1. An Overview of the Design Imperatives

The most difficult task in designing an ILCEE tax is to define waste. Admittedly, this has been the definitional problem that’s been the chief barrier to other possible

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299 Id.,
300 Id. at 1087
301 Id. at 1085
302 Id.
303 As previously noted (see supra notes 266, 273-274 and accompanying text), treating excess salaries as an excess benefit transaction under IRC §4948 is not necessarily an option because the salaries are likely commensurate with the services offered and are not excessive in and of themselves. Rather, in the case of a wasteful trust or fund, it’s the services funded/offered that are excessive. Prof. Colombo’s articulation of this aspect of the private benefit rule provides a clear case for extrapolation to the broadened context of all forms of ILCEE waste.
solutions of charitable waste, raised repeatedly in this article as an almost insurmountable block to resolution of a number of issues that either cause the ILCEE problem or prevent its resolution. The issue of what’s wasteful is daunting primarily because it’s such a subjective determination that it’s hard to garner consensus on the subject.

Despite the definitional difficulty in these other contexts, I believe a well-designed ILCEE tax can avoid much of the lack-of-consensus-problem that plagues attempts to define waste. This is because, as noted in the last section, in the tax context wastefulness isn’t being examined as an abstract concept. Rather, it’s anchored by economic realities as the trade-off for governmental subsidy. In fact, since the subsidy is a privilege, Congress could define this trade-off (or stated differently, the condition for the privilege of the subsidies) anyway it wants, including establishing a relatively low ceiling for non-wastefulness. As long as there’s sufficient evidence that exceeding the established ceiling constitutes at least a “failure to conserve,” the tax will have doctrinal integrity under the private benefit rules advocated in this article.

But establishing a low ceiling (even if justifiable) would be extremely unwise as a matter of policy because it’d be counter-productive to the public/community benefit we want charities to provide. The ceiling should not be set so low as to only allow the lowest-common-denominator of benefits, or to potentially discourage charitable activity altogether. This would undermine much of what is good about the very reason for the government subsidy. Can you imagine our national museum treasures, like the Getty Museum or MOMA, if they’d been built as replicas of typical government buildings? The cultural loss would be tremendous. For this reason, I argue in favor of a very high allowance ceiling before imposition of an ILCEE tax to provide a wide margin for error for possible misjudgments, ex ante short-sightedness, and the aspirational, inspirational and visionary work of nonprofits. In addition, perspectives on wastefulness are extremely temporal in that they reflect the standards of a given point in time. Any ILCEE tax, even if it only kicks in after a very generous safe harbor ceiling, must also acknowledge the temporal nature of the perspective. Moreover, since by definition ILCEE waste is legal, it’s important to incorporate into any design criteria non-judgment about the activities of the charity. I call this a “do-no-harm-to-the-reputational-good-of-a-charity” consideration that should be accommodated in the ILCEE tax design, if possible.

The above overview of design imperatives illuminates a useful approach to take in framing an ILCEE tax. First, establish a baseline reference to anchor a determination of governmental waste. Next provide a very generous multiplier on this baseline to allow a wide margin for error, trusting that the expressive function of the tax will curtail abuse even further. Third, consider how the tax might accommodate the temporal nature of any

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304 See supra discussions in Part II.C. (explaining the insipid taxpayer response to charitable waste), Part IV.A.1. (explaining the waste doctrine’s focus on dissipatory waste rather than nonurgent expenditures), and Part IV.A.2. (discussing obstacles to cy pres actions based on waste).

305 This trade-off perspective isn’t the same as an attempt to devise a dollar-equivalent quid pro quo for benefits, which would be impossible to do given qualitative considerations previously discussed. (See supra note 154 and accompanying text; Brody & Tyler, supra note 129, at 57). However, a trade-off perspective does acknowledge that the governmental benefits are not provided in the abstract, but rather are in exchange for some public benefit(s), including the simple benefit of added plurality.

306 See supra Part V.B.
waste definition. Finally, avoid negative connotations from the tax. The rest of this Part elaborates on these proposed necessary aspects of any ILCEE tax.

2. The Baseline Reference - Government vs. Market Rates

A significant portion of this article has emphasized that the dividing line between illegal waste and ILCEE waste under current laws is based on optimum market rates. In other words, waste is typically defined as an excess of what the highest and best free market cost would be for products or services, i.e., what the competitive free market will bear in terms of how much to spend, for example, on compensation of a highly-sought-after executive or controlling person, the square footage charge for a new state-of-the-art building, or the research initiatives of a medical or technology nonprofit. Market rates offer a very efficient model to use since they involve little judgment and easy reference to industry market standards, frequently published. But a market baseline also leads to a domino effect or endless spiraling up of allowable parameters. Every new market rate becomes a comparable rate for assessing the reasonableness of the next market rate, and then that next market rate sets the standard for the next even higher market rate. Moreover, even without such upward spiraling, the free-market will always have a price for a lavish expenditure while government rates should not because those expenditures are likely outside the government’s budget comprehension.

This is why the free-market and government constitute different economic sectors of our society. The nonprofit sector exists at the intersection of these other two sectors and sometimes the distinction between free-market and government gets blurred at the borders. Thus, when free-market standards are used to judge illegal private benefit or private inurement in the nonprofit tax regime, it’s no wonder that the sky appears to be the limit and that it’s hard to reign in excessive salaries and product expenditures. But there’s definite room for reigning in these expenses as a matter of taxation rather than as a matter of illegality, based on the condition/trade-off of government subsidy.

Accordingly, when government subsidy is involved, I posit that the baseline standard should be what the government rate would be for the applicable expenditure. This requires reference to government rate standards, which are generally not tied to the highest market rate for an item or service. The federal government offers a lot of standards that local governments and private entities use for accessing the appropriateness of expenditures. For example, the federal government annually publishes mileage rates for automobile travel in the course of government business and daily rates for meal expenses by government employees (called “per diems”). I acknowledge that market rates can be tracked to numerous transactions and contracts, while government rates for a lot of activities and expenditures aren’t as easily referenced. Still, government

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307 See supra Part IV.B.
308 See e.g., Manny, supra note 18, at 742-744
rates are discernable. At a minimum, average figures can be garnered from a most recent history of express grant contracts and government contract bidding operations.

Thus, the expenditures made by charities should be compared against government contracting expenditures, rather than potentially already exorbitant market rates, as a baseline reference for an ILCEE tax to determine whether the expenditures should be subsidized or taxed. But the governmental rate should only be a starting point. A significant multiplier is needed to accommodate other considerations before establishing a safe-harbor ceiling below which an ILCEE tax should not kick-in.

3. A Significant Multiplier for Subjectivity and Charitable Ingenuity

Any multiplier on the baseline government rate must at least allow for two distinct, although sometimes overlapping, considerations. First, the multiplier must be sufficiently generous to allow for the inherent subjectivity of a wastefulness determination. Second, it must absolutely provide a margin for the exercise of the aspirational, inspirational and creative muscles of charities.

a. Allowance for Majoritarian Subjectivity

Once the government-rate baseline is established per the above discussion, the ILCEE tax design must go further to allow for significant taxpayer subjectivity about whether the expenditure by a charity so exceeds governmental parameters as to be considered lavish. This might be termed the “consensus factor.” In other words, at what factor beyond a government rate, would a majority of taxpayers at least entertain the possibility that a charity spent lavishly, even if a significant minority might still disagree that the expenditure was lavish. I might peg this consensus factor at 3-4 times what the government rate might be. That’s when I’d personally at least start to pay serious attention to the nature of the expenditure. After that, I admit my response to a given expenditure might be different depending upon whether it saved lives, sheltered battered women, increased career opportunities, provided basic shelter, helped animals, expanded education, etc., or otherwise supported my values (versus those of other taxpayers)\(^{311}\).

So, for example, in my world a charity might spend 3-4 times the compensation the government might spend to hire a chief executive for the charity with similar responsibilities to a governmental department head or to retain an architect on a project before I’d begin to get concerned. But as a middle-class academic I realize I have a different perspective than many and have little idea how my perceptions resonate with other taxpayers. Realizing my personal prejudices, I leave the multiplier that might capture majoritarian subjectivity (i.e., the point above the government rate where most taxpayers would begin to allow some recognition of excess) to the experts. There are empiricists and economists far more qualified than I to figure out the appropriate multiplier to discern where majoritarian allowance meets resistance. The important point is that an ILCEE tax should not kick-in until at least this point is reached. Moreover, I fervently believe in an additional multiplier to ensure preservation of the best that charities might offer – aspiration, inspiration and creativity.

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\(^{311}\) See supra Part II.C. (discussing the subjective nature of the definition of waste).
b. **Allowing for Charity Ingenuity**

When government subsidy is involved we’re typically dealing with current day perspectives by the median voter as opposed to the visions of potentially the most creative thinkers in society. So, as a matter of government financing, ingenuity is often a step-child to the practical and proven. In this regard, governmental practicalities often butt up against a basic *raison d’être* of many nonprofits - to nudge societal thinking toward things aspirational, inspirational and creatively different, to fuel needed change and thus carry-out the pluralistic attributes we so value.  

Charities and the donors who funded innovations have given society some of the best concepts, architectural buildings, cultural environments, and leaders that civilization has produced. So local, organic farming that promotes pesticide-free food products, or symphony halls that today attend to fine acoustical issues, or museums that provide adequate light and angle perspective on displayed art are now seen as fundamental, and future budgets for such would likely be considered totally appropriate for government subsidy, rather than an ILCEE matter. That’s because charities have taught us how environment can affect receptivity to art and other matters.

So, whatever multiplier is used for an ILCEE tax (*i.e.*, a multiple of the governmental rates for given expenditures), there must be significant allowance to still encourage aspiration, inspiration and creativity. For example, today garbage recycling and children’s educational television are considered part of basic notions of environmental and pre-school education responsibility. But these initiatives were ridiculed in their early days, and relegated to the nonprofit sector because of market-failure. We now can view these initiatives as aspirational, inspirational or creative for their times. I refer to this constellation of attributes as “charity ingenuity” herein. Any tax regime applicable to charity should ensure it doesn’t operate so onerously that it squelches vital charitable ingenuity.

What does all this mean in terms of an appropriate multiplier? Again, as noted above in the context of majoritarian subjectivity, I defer to empiricists and economists to garner and calculate the appropriate multiplier for allowance of charitable ingenuity. Still, by way of anecdotal reference, if my personal preferences were sole determinants, I might well recommend a 5-6 times multiplier to retain this essence of what I hold very dear about charities. Again, I acknowledge that my choice of a multiplier is totally intuitive and not based on any empirical or economic analysis. Moreover, I assume it more liberal than many taxpayers.

That said, when I test my intuitive sense for both allowances – majoritarian subjectivity and charity ingenuity - it adds up to a total multiplier of about 10. Not surprisingly to me, this is an admittedly large aggregate multiplier that would still result in curtailing a lot of instances that I consider as ILCEE waste. For example, although a number of current charity salaries that many would consider excessive expenditures when compared to salaries of top government officials would be below the safe-harbor ceiling, despite the largeness of this aggregate multiplier, lots of others would be above it. Specifically, each member of the President’s Cabinet makes under $200,000 in base

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312 *See e.g.*, Goodwin, *Ask Not*, *supra* note 164, at 76, 98-99.
313 Consider for example the open-space views enjoyable at the free-admission Getty Museum in Los Angeles, or new symphonies, new medicine, psychiatry, *etc.*
salary today. Only a few congressional leaders exceed this amount and they are all paid less than $230,000 per year. Allowance of a 10 times multiplier of the highest governmental rate as an ILCEE tax floor would mean a charity executive could make a salary of $2,300,000, assuming his/her duties comparable to those of a cabinet member or Congressional leader, before the charity would be subject to any ILCEE tax consideration. I think many taxpayers would agree that a salary 10 times that paid to the highest-ranking government officials should not be subsidized by the government and should be taxed above these amounts. Still, salaries that significantly exceed this $2.3 million mark are regularly occurring in the charity world daily in 2009.

Wow! So even using a 10-times-government-salary-rate guide, there’d be a number of charities facing an ILCEE tax under my suggested tax regime. Moreover, the number of charities to which an ILCEE tax might be applicable, even with a 10 point multiplier, is likely to be significantly higher when the salaries of lower-level employees are compared to lower-level government staffers.

4. Acknowledgment of the Temporal Nature of a Wastefulness Judgment

As a third significant point, the design of an ILCEE tax should also allow for the extremely temporal nature of any charitable use determination. In this regard, some charities mire society in the out-moded and dated because that’s the world their founders and donors believe in. On the other hand, more progressive charities might incur expenditures that some could consider frivolous and wasteful at a given point in time, but which may later be viewed as essential.

Thus, in designing a tax, Congress must be mindful that a narrowly tailored ILCEE tax might cause charity managers to choose present realities over future vision. Accordingly, it’s important to understand that what’s considered an appropriate government subsidy as a matter of ex ante value-analysis at a given point in time is a temporal judgment that may change based on ex post perspectives. To accommodate this issue I recommend that any wastefulness ceiling only be applied over a period of time, rather than annually, like a minimum 5 year rolling period similar to the current rolling period used to assess whether a charity is a public charity or a private foundation, based on its income sources for the applicable period.

5. Avoiding Negative Connotations – a Naming Game

Initially I considered referring to an ILCEE tax as a “waste” tax. However, upon reflection I thought the reduction of meaning to a single negative word far too potentially pejorative and depreciative for all situations where an ILCEE tax may be appropriate. Terminology does matter and it’s important to not potentially prejudice attitudes towards

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315 See supra notes 17-19 and accompanying text and authorities.
316 See, e.g., supra note 210 and accompanying text (discussing the Robertson vs. Princeton litigation).
317 This is a different point from that of a rise in the cost of living. A temporal adjustment references a shift in societal values. This is in contrast to a cost-of-living adjustment for the same/previous societal values. A high-fiber diet may have cost SX in 2009, but now costs SX + Y in 2010 due to a rise in the cost of living. On the other hand, a shift in societal valuation of a high-fiber diet (versus a market rise due to the cost of living) could turn the market for a high-fiber diet from $X in 2009 to a $Z market in 2010.
318 Treas. Reg §170A-9(e)(4)(i), (ii). See also FISHMAN & SCHWARZ, supra note 25, at 799.
expenditures which may eventually prove quite beneficial to society with implications of judgment or blame derived from simple semantics and word choice. So this terminology point reinforces a more general one about what may be seen, *ex ante*, by an average taxpayer, at a given temporal point in time, as an excessive expenditure.

True, the lavish expenditures I speak of in this article may be offensive to taxpayer sensibilities in the present. But as just noted regarding allowance for the potentially temporal nature of a wastefulness judgment, equally true is the fact that these same expenditures maybe later judged as setting a new standard of excellence in architecture, design, functionality, education or visionary leadership. In fact, they may, at some point *ex post*, be viewed as almost minimalist. This is why it’s extremely important not to demonize the applicability an ILCEE tax. In fact, a charity should feel it has the non-judgmental/expressive room to exceed any ceiling that might trigger an ILCEE tax (*e.g.*, a government rate times a significant multiplier that allows for charitable values and other exigencies) and not be marred by negative impressions. This is the only way to truly allow for charity ingenuity.

I envision scenarios where charities will be lauded for their efforts at ingenuity, despite costs that might trigger an ILCEE tax. So it’s important that any triggering of an ILCEE tax shouldn’t convey blame or malfeasance. This means careful consideration of the naming of any ILCEE tax is required. Left to my druthers I might recommend terms like a “SEAL” tax, for subsidy expenditure allowance limit, or a “MACS” tax, for maximum appropriate charity subsidy, or even a “STET,” for superior tier expenditure tax, implying some potential superiority of quality from the expenditures. Again, I leave this matter to those more creative than I to resolve. My point is only to note that a neutral-sounding name for the tax is important.

**D. Ultimate Reliance on the Expressive Function of the Tax**

Some may argue that I’m so overly generous with multipliers and sensitivity to stigmatization that my tax proposal might allow too much ILCEE waste to go untaxed. They may prefer that multipliers applicable to government rates be set relatively low to ensure that more ILCEE waste is taxed than not. After all, taxation is generally something that prides itself on accuracy of application. In other tax situations I might agree and argue for narrow accuracy over broadened leniency. But in the context of a charitable waste debate, I believe leniency should champion. My reasons are four. The first three have already been emphasized in this Part: 1) recognition that defining wastefulness in any given circumstance is highly subjective as a majoritarian matter; 2) appreciation that charitable ingenuity must be given a wide swath; and 3) that a large-margin-for-error-multiplier acknowledges that charities are only partially government financed and that private monies also contribute significantly to the viability of charities. The fourth reason - the potential expressive function of an ILCEE tax - has not been previously addressed and warrants elaboration as an independent matter from the tax design criteria.

Laws have multiple functional purposes. At a minimum, scholars emphasize the descriptive, normative and expressive functions of various laws as a way to organize their import.319 In this regard, I believe an ILCEE tax can have an extremely important expressive function – establishing a clear societal value of anti-exorbitance as a standard

for the application of government subsidy. The absence of such a clear anti-exorbitance law in the current legal regime is a significant failing that must be cured.\textsuperscript{320} Such an expressive function can be achieved by the mere existence of an ILCEE tax. The proposed tax would make a fundamental statement about taxpayer and government approval of charitable expenditures relative to subsidy limits. The very fact of an ILCEE tax, no matter how high the safe-harbor ceiling before its application, would cabin offensively lavish expenditures by acculturating donors, charities and taxpayer to full awareness of the fact that charities are significantly subsidized by public monies (as well as private dollars) and the implications of this subsidy. Instances of imposition of the tax would operate to serve as objective data that would heighten taxpayer awareness of the subsidy. And donors and charities would be reminded that taxpayer tolerance/intolerance parameters (in contrast to consumer-tolerance) exist and that we should be ever-mindful of these limits. Thus an ILCEE tax would serve an expressive function that could help keep a charity’s actions within normative expectations of taxpayers. It would serve as a reminder of the joint public/private coordination and inputs represented by our current charitable system and emphasize the cooperation and compromise necessary to the system’s fairness and ultimate viability. In summary, a well-drafted ILCEE tax should have an expressive, tempering effect in service and recognition of the common goals of the sometimes disparate tripartite interests involved, \emph{i.e.}, those of government, charities and donors, rather than dominance by any party.

\textbf{CONCLUSION}

Our government provides huge subsidies to charities.\textsuperscript{321} Yet, the primary method of financing these subsidies - the tax expenditure method\textsuperscript{322} - lacks such transparency and clarity that it dulls taxpayer response to wasteful, lavish spending by charities, which occurs just as regularly as other types of government waste, primarily due to the “restricted gift” phenomenon.\textsuperscript{323} Therefore, negative political responses that typically correct or curb governmental waste in other contexts aren’t as evident in the charity context. This is why another corrective measure is needed in the form of some type of charity anti-exorbitance law that can take the place of the lost political backlash.

In summary, taxpayers fail to react to ILCEE waste in the same manner as they do to other government waste for a number of inter-related and complex reasons that make political outrage and correction unlikely. Yet restrictive gifts that may dedicate funds to specific purposes or projects are common practice and, although they have positive impacts, they have a number of negatives, including being a breeding ground for possible ILCEE waste because they confine charitable activity to narrow purposes that may not need the funding provided.\textsuperscript{324} Restricted gifts also engender the accumulation of assets, rather than their current expenditure, which compounds the possible problem of surplus

\textsuperscript{320} “[O]rdinary moral discourse is right when it comes to ‘waste’: A reasonable society \emph{should} be concerned with nonurgent waste. We also can and should develop legal constraints against it.” McCaffery, Waste? supra, note 152, at 87.
\textsuperscript{321} \textit{See supra} Part I. B.1. and Part I.B.2.a.
\textsuperscript{322} \textit{See supra} Part I. B. 2.
\textsuperscript{323} \textit{See supra} Part III. A.-C.
\textsuperscript{324} \textit{Id.}
and ILCEE waste. In the absence of effective anti-exorbitance laws or incentives, the expenditure of excessive amounts for a restricted charitable purpose is more than just tempting – it may well be a mandatory directive of the terms of a restricted gift. Endowments and private foundations are the most likely vehicles for restricted gifts.

The earnings on restricted gift funds can be significant because the principal/corpus funds are usually invested rather than expended for current operations because of donor-restrictions typically mandating non-expenditure for current needs, in whole or in part. The donations of restricted gifts, like other donations, are tax deductible by the restricted gift donors. Moreover, the investment earnings on these funds are then mostly exempt from taxation, even though the charity may not currently be expending the restricted gift funds for public purposes because of restrictions in this regard. Part V supra posits that these deducted restricted gifts and their tax-exempt earnings should not continue to avoid taxation if and when they are used to fund ILCEE waste.

Unfortunately, as this article reveals, current laws, including the common-law doctrines of waste and cy pres, the tax law prohibitions against private inurement and more-than- incidental private benefit, and tax law intermediate sanctions applicable to private foundations, aren’t adequate to the task of curbing lavish expenditures by charities. Accordingly, this article recommends a new tax, targeted only at extravagant expenditures by charities, and offers specific design criteria for such a tax. In so doing, I acknowledge that I have no wish to make the requirements for compliance with Sec. 501(c) (3) even more onerous or complicated for nonprofits. Moreover, I draw no comfort from the prospect of the IRS determining when something is “wasteful,” since this is a daunting undertaking for anyone. But my concerns are significantly assuaged by the fact that if the guideline considerations I offer in this article for design of the suggested tax are followed: 1) a waste tax would only be imposed infrequently in rare situations, after application of generous multipliers, where at least some degree of “conspicuous consumption,” a/k/a waste, would generally be obvious and uncontested to almost all concerned; 2) even given this infrequency of application, the mere existence of the tax would serve an extremely valuable expressive function about charitable waste in general, and more specifically about respect for the public/private partnership that underpins our current charitable system; 3) the most likely charities to be taxed would be very wealthy private foundations who have the funds to pay the tax without sacrificing charitable mission; and 4) the tax could often be avoided by modification of restricted gift terms under state cy pres rules, with the tax recommended by this article helping spur initiation and success of cy pres actions based on waste when there might otherwise be little incentive for such actions or hope for their success.

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325 Id.
326 See supra Part III. D.
327 See supra Part I. B. 2.