How Charitable Organizations Influence Federal Tax Policy: "Rent-Seeking" Charities or Virtuous Politicians?

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NANCY J. KNADER

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I. INTRODUCTION

Since 1940, the number of tax-exempt charitable organizations in the United States has increased from 12,500 to 750,000—representing over six times the growth that occurred during the same period among for-profit businesses. United by a common interest in maintaining favorable federal tax subsidies, this otherwise diverse group of charitable

1. Tax-exempt charitable organizations are described in § 501(c)(3) of the Internal Revenue Code of 1986, as amended. I.R.C. § 501(c)(3) (1995). This Article refers to such organizations as “charitable organizations” or “charities” rather than “tax-exempt” or “nonprofit” organizations. This is because “charitable” denotes a specific subset of the larger universe of tax-exempt or nonprofit organizations, namely those organizations described under § 501(c)(3) that are both exempt from federal income tax and entitled to receive tax-deductible contributions. See infra text accompanying notes 68-120. Other authors have used various terms to refer to the same group of organizations. See, e.g., ALAN J. ABRAMSON & LESTER M. SALAMON, THE NONPROFIT SECTOR AND THE NEW FEDERAL BUDGET 11, 13 (1986) (defining “nonprofit sector” more broadly as a “subset of all 501(c)(3) and 501(c)(4) organizations—i.e., those that deliver services of a charitable, education, or related character”); WILLIAM G. BOWEN ET AL., THE CHARITABLE NONPROFITS: AN ANALYSIS OF INSTITUTIONAL DYNAMICS AND CHARACTERISTICS 4 (1994) (adopting the term “charitable nonprofits” to distinguish from the many organizations exempt from federal income tax that are not operated for a charitable purpose); PETER D. HALL, INVENTING THE NONPROFIT SECTOR AND OTHER ESSAYS ON PHILANTHROPY, VOLUNTARIISM, AND NONPROFIT ORGANIZATIONS 14 (1992) (using the term “nonprofit sector” to refer to “charitable tax-exempt organizations”); THE NONPROFIT SECTOR IN THE MIXED ECONOMY 1 n.1 (Avner Ben-Ner & Benedetto Gui eds., 1993) (noting that the term “nonprofit” is generally accepted in the United States, but not in other countries); JERALD SCHIFF, CHARITABLE GIVING AND GOVERNMENT POLICY: AN ECONOMIC ANALYSIS 5 (1990) (using “charitable sector” to refer to § 501(c)(3) organizations because such organizations are “directly influenced by tax policy”); BURTON A. WEISBROD, THE NONPROFIT ECONOMY (1988) (adopting the term “nonprofit”).

Charitable organizations refer to themselves as the “independent sector” which is also the name of an umbrella organization of charitable organizations. See infra text accompanying notes 192-97.

2. The figure for 1940 is based on the estimated number of secular charitable organizations. HALL, supra note 1, at 13. The IRS did not begin to keep statistics on the number of charitable organizations until 1967. Id. at 1 n.1. The rapid growth of the charitable sector has outpaced scholarly treatment of (and indeed interest in) its characteristics, resources, and behavior.

3. HALL, supra note 1, at 62 (comparing an “eightyfold” increase in charitable tax-exempt organizations with a “mere sevenfold increase” in the number of business corporations).

organizations has coalesced to form a distinct and effective interest group.\(^5\) Today, this group exerts considerable influence over Congress, the Department of the Treasury, and the Internal Revenue Service in matters dealing with exemption from federal income tax and the tax deductibility of charitable contributions.\(^6\)

This Article presents two recent cases where the charitable community successfully withstood the threat of negative tax regulation.\(^7\) Some commentators criticize the ability of charitable organizations to successfully influence the formulation and implementation of federal tax policy, while others applaud it.\(^8\) Ultimately, one’s reaction depends on a judgment about what degree of influence charitable organizations should have over the legislative (or regulatory) process.\(^9\) This Article takes one step back and asks the basic question: why do charitable organizations wield any political influence?

\(^5\) This Article argues that the diverse group of organizations that comprise the charitable community share only their common status under § 501(c)(3). See infra text accompanying notes 79-80. Because of the community’s dependence on tax status, its resources are focused on the maintenance of existing tax subsidies.

\(^6\) Part III of this Article describes two recent instances where the charitable community exercised significant political muscle. It does not declare that charitable organizations have “captured” these tax institutions. For a discussion of the public choice theory or interest group capture see infra text accompanying notes 326-39. The conclusion that interest group influence amounts to “capture” carries with it a normative determination that the degree of influence exhibited by the interest group is disproportionate and, therefore, undesirable. Einer R. Elhauge, Does Interest Group Theory Justify More Intrusive Judicial Review?, 101 YALE L. REV. 31, 48 (1991) (opposing the use of interest group theory to justify more intrusive judicial review because of its dependence on a “normative baseline”). Instead, the goal of this Article is to reveal the input charitable organizations have in the formulation and implementation of federal tax policy. Once revealed, the question then becomes why charitable organizations are able to exert such influence. Thus, this Article does not focus on the interest group theory of capture or its predictive ability. Instead, its focus is on the interest group itself. See infra text accompanying notes 306-07.

\(^7\) In both instances, the charitable community appealed directly to the IRS, the Department of the Treasury, and members of Congress. It argued that the proposed rulemaking would hurt the community’s ability to raise the revenue necessary to perform its charitable functions. After public hearings, hundreds of written comments, the threat of legislation, and, in one case, a congressional report attached to the IRS appropriation bill urging the agency to reconsider its position, the proposed administrative action was abandoned. See infra part III.

\(^8\) See infra note 172.

\(^9\) This follows Elhauge’s point that the determination that an interest group has “captured” an agency “depend[s] implicitly on . . . baseline views of what degree of influence is appropriate for that group.” Elhauge, supra note 6, at 48 (“[I]nterest group theory provides us with no reason to condemn (or approve) the operation of the political process that stands independent of our condemnation.”).
A thorough consideration of this question requires: (i) an understanding of the composition and resources of the interest group; (ii) evidence of influence over legislators (and regulators); and (iii) insight into the motivation of political actors. The public choice theory and public interest theory of legislation provide two competing models of the political actor (i.e., self-interested and public-interested). The specific instances of influence over tax institutions can be pieced together from a wide variety of sources, including the trade press of the charitable community and specialized publications of the tax bar. What is missing, however, is a detailed understanding of charitable organizations, including such fundamental issues as the role they play in today's economy, the motivation of their managers, and the effect of tax subsidies on their formation and operation

This Article uses both public choice and public interest analysis as a tool to help identify various features of the charitable community. Taken together, a public choice analysis and a public interest analysis pose questions about what are the polar extremes of human motivation. Public choice asks what charity offers the self-interested legislator. Public interest asks what charity offers the public-spirited legislator. With the questions thus framed, this Article proceeds to identify certain characteristics of, and assumptions regarding, this emerging and powerful interest group.

The Article concludes that the influence of charitable organizations over tax policy can be explained from either a public choice or public interest vantage point, despite what appears to be some initial

10. Often presented as competing views of the legislative process, the public choice and the public interest theory of legislation both make fundamental assumptions concerning the motivation of the political actor. In their most simplified terms, public choice theory posits a rational self-interested political actor, whereas public interest theory assumes that a political actor seeks to maximize the public interest and not his or her self-interest. Legal scholars often cite Dennis Mueller's definition of public choice—"the economic study of nonmarket decision making, or simply the application of economics to political science." DENNIS C. MUELLER, PUBLIC CHOICE II at 1 (1989). See infra note 326. For a description of the public choice or interest group theory of legislation see infra text accompanying notes 326-39. For a description of the public interest theory of legislation see infra text accompanying notes 424-35.
11. See infra text accompanying notes 371-76.
12. See infra text accompanying notes 493-94.
13. As illustrated in Part IV, the interest of the supposedly self-interested legislator and the public-spirited legislator converge when the public choice model is augmented to include items other than votes and contributions. The result is a public-private continuum of human agency where one cannot make a meaningful distinction between a private motive and a public motive. See infra text accompanying notes 396-97.
challenges. Moreover, it concludes that the charitable community as
defined in Section 501(c)(3) is not just another interest group vying for
favorable subsidies. Upon examination, the wide congressional appeal of
charitable tax subsidies extends beyond simply a desire to provide tax
breaks for a diverse group of organizations that to some extent supply
public goods. Instead, it represents the endorsement of a fundamental
reallocation of responsibility between the federal government and the
charitable community for certain social services.

The deficit reduction and fiscal restraint policies of the last fifteen
years have led both the executive branch and the legislature to emphasize
the importance of private volunteer efforts. As the federal government
reinvented itself, it expanded the role of the charitable community. President Bush's Points of Light Foundation and President Clinton's
Americorps represent two of the most widely-publicized attempts to
courage volunteerism and other private acts of charity. As explained
below, this newly-configured charitable community has something to offer
both the self-interested and the public-spirited legislator.

The reallocation of responsibility and resulting relationship between
the government and the charitable community has many implications.
Three are readily apparent in the case studies presented in Part III. First,

14. For example, from a public choice perspective a charitable organization
should be a relatively weak player in the political marketplace because it is prohibited by
the terms of its tax exemption from engaging in any political activities. See infra text
accompanying notes 105-09.

15. On related fronts, charitable organizations have been under congressional
scrutiny regarding proposed: (i) lobbying disclosure rules; (ii) limitations on the advocacy
work of charities receiving direct federal funding; and (iii) reductions in postage rate
subsidies. In addition, Congress has inquired as to the activities of other non-charitable,
tax-exempt organizations, such as the highly publicized hearings on the activities of the
American Association of Retired Persons (AARP). For a brief discussion of the various
types of non-charitable, tax-exempt organizations see infra text accompanying notes 68-80.

16. For a description of the market failure explanation for charitable organizations
see infra text accompanying notes 142-62.

17. Congress and the charitable community justify the continued favorable tax
treatment by pointing to the expanded role of the charitable community. See, e.g., infra
note 222.

18. For a discussion of the ideology of restraint budgeting and reducing the size
of the federal government in favor of increased responsibility of the private sector and
state and local authorities see infra text accompanying notes 441-64.

19. An extreme example of this new reliance on private charity is the proposal
by Lamar Alexander, former candidate for the 1996 Republican nomination for President,
that the federal government turn over Aid to Families with Dependent Children and the
food stamp program to private charities. See Jennifer Moore, Alexander's Plan for the
Poor, CHRON. PHILANTHROPY, Mar. 7, 1996, at 27; Kevin Sack, Alexander Builds His

20. For a discussion of both programs see infra text accompanying notes 498-501.
there is increased cooperation between the IRS and the charitable community in the development of pro-charity rules and regulations.\textsuperscript{21} Second, the community demands "durable" tax subsidies\textsuperscript{22} as it jealously guards its present tax subsidies and urges the legislature to resist the application of doctrinally sound tax policy that might lessen the value of such subsidies.\textsuperscript{23} Finally, the rhetorical force of the new institutional role of the charitable community insures that any debate concerning the tax treatment of charitable organizations is cast in broad generalities and does not delve into the merits of the continued subsidy. This means that legislators need not evaluate each piece of pro-charity legislation. It is sufficient that the legislation is labeled "good for charity."

At first glance, the political power held by charitable organizations seems to challenge the accuracy of the public choice model of the demand for, and the supply of, legislation in the political marketplace.\textsuperscript{24} Under a public choice or interest group theory of legislation,\textsuperscript{25} charitable...
organizations should be politically impotent because the very terms of their status as charitable organizations prohibit political activities.\textsuperscript{26} Thus, they lack access to the preferred medium of exchange used to secure favorable legislation (or forestall negative legislation)—votes and campaign contributions.\textsuperscript{27} Even a comprehensive package of incidental items, such as honoraria, future employment opportunities, and favorable public relations\textsuperscript{28} provides a relatively weak explanation for the observed behavior of legislators.\textsuperscript{29} Moreover, as Edward Zelinsky recently theorized, tax institutions are less subject to interest group influence than direct spending programs because of the competition among interest groups for favorable tax subsidies.\textsuperscript{30} Thus, in the case of charitable organizations and tax institutions, the interest group should be weak and the target should be relatively resistant to influence.

However, the difficulties disappear when one views charities in the context of their emerging institutional role. Reallocation offers the self-interested legislator a golden management opportunity.\textsuperscript{31} It permits the legislator to: (i) shift the responsibility for certain social services; (ii) claim credit for encouraging more efficient delivery of needed social

\textsuperscript{26} Organizations described in \S 501(c)(3) cannot engage in any activities on behalf of or in opposition to candidates for political office. This prohibition includes candidate endorsements as well as campaign contributions. See infra text accompanying notes 105-09.

\textsuperscript{27} Votes and campaign contributions are the most common medium of exchange. See infra text accompanying notes 378-89. It is possible that charitable organizations exchange items in lieu of votes and campaign contributions, such as honoraria, future employment, and favorable public relations. See infra text accompanying notes 396-420.

\textsuperscript{28} Many commentators expand the model to include items other than dollars and votes. See infra note 396.

\textsuperscript{29} Part IV considers a number of proposals to explain why legislators are responsive to the lobbying efforts of charitable organizations. These include widespread graft and noncompliance with the restrictions on political activities, speakers’ fees, future economic opportunities, advertising, and current board loyalties. See infra note 396.


\textsuperscript{31} See infra text accompanying notes 510-19.
services; and (iii) avoid accountability for any unfavorable consequences. The only cost is the maintenance of two very popular tax subsidies. The reallocation of the charitable community is superior to delegation to an administrative agency because the legislature does not retain ultimate responsibility for the outcome. In fact, the legislature shifts such responsibility and the burden of support not just to the charitable sector, but to the American people.

From a public interest perspective, pro-charity legislative activity offers tantalizing proof that legislators are not motivated solely by self-interest because charities cannot enhance a legislator’s chance of reelection with a promise of votes or cash. What seems to be missing, however, is any deliberation as to the merits of any of the proposed legislation. Instead, there is an apparent presumption of noninterference with the tax subsidies enjoyed by charitable organizations, which is probably a consequence of the larger policy of reallocation and the desire to strengthen private charitable efforts. In the opinion of many legislators, a strong charitable community furthers the public interest because it fosters self-reliance and reduces the scope of federal government social programs.

For those skeptical of the public/private distinction separating the self-interested legislator from the public-interested legislator, it is not

32. The ability of a legislator to claim credit for certain position taking is an important method of “advertising” and influencing voter opinion. See Michael T. Hayes, Lobbyists and Legislators: A Theory of Political Markets 81 (1981) (describing Mayhew’s “plausible credit-claiming”); see also infra text accompanying notes 504-06.

33. See supra note 4.


35. For a discussion of delegation to administrative agencies see infra text accompanying notes 511-18.

36. For a discussion of the public interest theory of legislation see infra text accompanying notes 424-35.

37. The testimony offered at the hearings was unanimously in favor of the action (or inaction) requested by the charitable organizations. The public debate in Congress was a recitation of the good things that charitable organizations do for the country. Absent was any discussion of larger issues of tax policy. See infra text accompanying notes 438-40.

38. For a discussion of the ideological appeal of this reallocation see infra text accompanying notes 485-503.
surprising that either model of human motivation can explain the political influence of charitable organizations. Both models invite a tautology where the actions of a legislator are explained by reference to underlying assumptions regarding the appropriate model of the political actor (self-interested v. public-interested). For example, virtually any act by a legislator can be considered self-interested simply because the legislator chose it. Thus, even acting in the public interest can be motivated by self-interest if the legislator develops a "taste" for the public interest.

This Article does not try to establish whether the initial choice of legislators to support the reallocation was motivated by self-interest, concern for the public interest, or simply economic exigencies. Knowledge of the real motive, if an individual can ever act based on a single motive, remains impenetrable, and testing for it is, at best, unreliable. No doubt the public choice and public interest theories will continue to be used as predictive, as well as prescriptive, models. But strict adherence to either theory denies the ease with which motives travel the private/public continuum of human agency and offers only a limited ability to explain the human political condition. Here, the theories are used only to provide a framework for the identification of characteristics of charitable organizations, particularly as they exist in this post-deficit reduction economy.

Part II describes the statutory parameters of the charitable sector with particular emphasis on the requirements for tax exemption and the ability to receive tax-deductible contributions. It also summarizes the leading rationales for such favorable tax treatment. Part III establishes that the


41. See, e.g., Kelman, supra note 39, at 335; Shaviro, supra note 40, at 71. A common criticism is that public choice analysis can identify any regulation as "proof" of interest group capture by asserting that it helps (or perhaps harms) an interest group. The result is an impenetrable tautology. Another method is to identify the external indicia of capture, such as concentrated campaign contributions, and then test for capture. Because the testing entails looking for favorable regulation, it simply confirms the tautology. FARBER & FRICKER, supra note 34, at 27.


43. See infra text accompanying note 359.


45. See infra text accompanying notes 67-118.

46. See infra text accompanying notes 119-71.
charitable community is defined by reference to the Internal Revenue Code and has organized around such common tax status, rather than along industry lines.\textsuperscript{47} It then reconstructs two recent cases where the charitable community identified potentially unfavorable regulation when it was at a very early stage of policy formation and quickly mounted a successful lobbying campaign.\textsuperscript{48} Part IV illustrates that either public choice or public interest theory can explain the political influence of charitable organizations, provided one considers the reallocation of responsibility for certain social services to the charitable community and the emerging relationship between it and the federal government.\textsuperscript{49} It also reveals the unspoken assumptions supporting the reallocation, principally the preference for private charity rather than government programs and the failure to differentiate among the wide variety of organizations comprising the charitable sector.\textsuperscript{50} Part V examines the terms of the reallocation, and the possibility that charitable organizations demand durable tax subsidies in consideration for accepting the nondistribution constraint of the charitable form. A brief conclusion highlights the areas for future study and stresses the need for the development of a positive theory of charitable organizations.

II. THE TAX-BASED DEFINITION OF CHARITABLE ORGANIZATIONS

Before addressing the role of charitable organizations as an effective interest group, it is essential to understand the diverse mix of organizations that qualify for tax-exempt status under Section 501(c)(3) of the Internal Revenue Code. Charitable organizations cut across many industries. They include hospitals, universities, museums, day care centers, and soup kitchens.\textsuperscript{51} Although these organizations have disparate purposes, organizational structures, and funding sources, they share a powerful bond—exemption from federal income tax\textsuperscript{52} and the ability to receive tax-deductible contributions.\textsuperscript{53} The case studies presented in Part III illustrate how the charitable community lobbies extensively to maintain, and sometimes enhance, these two subsidies. This section describes the current composition of the charitable

\textsuperscript{47} See infra text accompanying notes 190-201.
\textsuperscript{48} See infra text accompanying notes 202-305.
\textsuperscript{49} See infra text accompanying notes 306-09.
\textsuperscript{50} See infra text accompanying notes 441-81.
\textsuperscript{51} For a discussion of the diversity of charitable organizations see infra text accompanying notes 79-80.
\textsuperscript{52} I.R.C. § 501(c)(3). See also infra text accompanying notes 67-109.
\textsuperscript{53} I.R.C. § 170(c)(2). See also infra text accompanying notes 110-18.
community. In particular, it focuses on the requirements and the rationales for the two subsidies of tax exemption and tax-deductibility of contributions.

In addition to favorable federal tax treatment, charitable organizations enjoy a preferred status in society. Charitable organizations receive a staggering amount of voluntary support from the general public. For example, in 1995, individuals transferred $116.23 billion to charitable organizations. Individuals also contributed approximately 19.5 billion hours of volunteer labor to charitable organizations. In the words of a marketing executive, "People trust

54. The charitable sector is commonly referred to as the nonprofit sector. The term "nonprofit," however, is potentially misleading. A charitable organization can make a profit. It is simply not permitted to distribute any profits to individual investors. The organization must retain any profits for use in the furtherance of its exempt or charitable purpose.


56. The exemption from tax acts as a government seal of approval. SCHIEFF, supra note 1, at 20-21 (describing how government subsidies indicate that "the charity is of a quality that the government has found acceptable"). This preferred status persists despite recent scandals, such as the controversy over the compensation of the former president of the United Way. See HOLLY HALL, UNITED WAY'S COMEBACK, CHRON. PHILANTHROPY, Jan. 26, 1995, at 19 (reporting an increase in contributions to the United Way after two lean years following charges that its former president William Aramony received an excessive salary and engaged in lavish personal spending with organizational expense accounts).

57. Total giving including corporations and foundations was $143.84 billion. JOHN MURAWSKI, A BANNER YEAR FOR GIVING, CHRON. PHILANTHROPY, May 30, 1996, at 30 (citing ANNUAL GIVING USA 1995). Estimates of charitable giving are published each year by the American Association of Fund-raising Counsel Trust for Philanthropy. It is widely cited as the authoritative source on statistics for charitable giving. The report for each calendar year is published the following summer. At the time of publication, many corporate donors have not even filed their income tax returns for the period covered by the report. Accordingly, GIVING USA bases its initial estimate on surveys of major charities, corporations, and foundations. Often, the edition of GIVING USA for the next year has to revise the earlier year's estimates substantially after taking into account income tax return data. Id.

nonprofits.59 Henry Hansmann theorized that this consumer trust is the result of the nondistribution constraint that forbids the distribution of the net profits of charitable organizations to private individuals.60 Other commentators attribute this consumer trust to the recognition that charitable organizations enhance pluralism and democracy.61 Whatever the source, consumer trust of charitable organizations continues despite persistent fundraising and compensation scandals.62

To qualify for the dual benefits of exemption from tax and deductible contributions, an organization must comply with a variety of requirements imposed by Section 501(c)(3).63 Some are affirmative, such as the charitable purpose and public benefit rules.64 The majority, however, are negative and are expressed as restrictions or limitations on an organization's activities. Combined, these requirements define the parameters of the charitable community.65 For purposes of this Article,

59. The quote continues:
We tend to believe in what they do, and almost more importantly, in how they do it. They are tackling the most pressing problems of our time for reasons other than personal gain. For this, we tend to grant them respect. We acknowledge their integrity. We give them our trust.

RICHARD STECKEL & ROBIN SIMONS, DOING BEST BY DOING GOOD 13-14 (1992). In the marketing industry this effect is referred to as the "halo effect." See, e.g., James W. Harvey & Kevin F. McCrohan, Changing Conditions for Fund Raising and Philanthropy, in CRITICAL ISSUES IN AMERICAN PHILANTHROPY 39, 59-60 (Jon Van Til ed., 1990) (describing the "halo effect").

60. For an explanation of this trust in terms of contract failure see infra text accompanying notes 143-48. For a discussion of the nondistribution requirement see infra text accompanying notes 143-48.

61. For an explanation of the preferential status of charitable organizations as the result of their contribution to democratic values see infra text accompanying notes 121-41.

62. See Elizabeth Greene & Grant Williams, Asleep on the Watch?, CHRON. PHILANTHROPY, July 27, 1995, at 1 (noting that recent scandals have "cast doubt on the ability of government to stop charity wrongdoing"); see also supra note 56.

63. The deduction for contributions to certain qualified charities is found under I.R.C. § 170. However, there is substantial overlap between I.R.C. § 501(c)(3) and § 170. All categories of organizations that qualify under § 501(c)(3), with the exception of one, are also qualified to receive tax-deductible contributions. For the text of § 501(c)(3) see infra note 79. For the text of § 170(c)(2) see infra note 111. The exception is public safety organizations. See infra note 110.

64. See infra text accompanying notes 81-86.

65. The common law concept of charity dates from the 1601 Statute of Charitable Uses, 43 Eliz. 1, ch. 4 (Eng.). To a large extent, however, the contemporary understanding of charity is constructed by the Internal Revenue Code. Charitable organizations are subject to various layers of regulation on the federal, state, and local levels. At the most fundamental level, charitable organizations are governed by common law concepts of charity derived from the 1601 Statute of Charitable Uses. In many states, the local probate court continues to have jurisdiction over charitable organizations despite incorporation under the state corporation code. See, e.g., 20 PA. CONS. STAT. ANN. §
the prohibition against any political activities or electioneering by charitable organizations is of particular interest.66

A. Exemption From Federal Income Tax67

The Section 501(c)(3) charitable organizations discussed in this Article are an important subset of a much larger group of organizations that are exempt from federal income tax, but are generally not eligible to receive tax-deductible contributions.68 Section 501 grants twenty-nine different statutorily-defined organizations69 exemption from federal income tax, subject to the rules relating to unrelated business income tax.70 The noncharitable tax-exempt organizations include trade associations,71 social clubs,72 fraternal organizations,73 and some more

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66. For a discussion of the prohibition on political activities see infra text accompanying notes 105-09. Charitable organizations are not permitted to engage in more than an insubstantial amount of lobbying activities. Various exceptions make this limitation generally inapplicable to the case studies presented in this Article. For a discussion of the lobbying restrictions see infra text accompanying notes 94-104.

67. In addition to exemption from federal income tax, charitable organizations may qualify for exemption from state income and sales tax and local property taxes. These various levels of exemption provide a layering of regulations, the terms of which vary widely. Neither organization on a nonprofit basis nor exemption from federal income tax (even under § 501(c)(3)) guarantees that an organization qualifies for state and local tax exemption.

Often overlooked, state and local tax exemptions are sometimes more valuable to the organization than the federal tax exemption. For example, assume that the revenue of a small, private elementary school barely exceeds its expenses. Further, assume that it does not have a substantial endowment so its investment income is negligible. In such a case, the federal income tax exemption does not produce a significant tax savings. If the organization owns its school building and the surrounding land, its most valuable tax subsidy may be the local property tax exemption. There have been recent efforts on both the state and local level to limit the scope of these exemptions. See Developments in the Law—Nonprofit Corporations, 105 HARV. L. REV. 1578, 1612 (1992).

68. For an explanation of those organizations not described in § 501(c)(3) that are qualified to receive tax-deductible contributions see infra note 112.

69. Section 501 exempts 25 different types of organizations. Subsections (a), (d), (e), and (f) of § 501 exempt four additional types of organizations.

70. For a discussion of the rules governing unrelated business income see infra note 93.

71. I.R.C. § 501(c)(6).

72. I.R.C. § 501(c)(7).
esoteric groupings such as Black Lung Benefit Trusts and Cooperative Ditch Associations. The IRS reports over one million tax-exempt organizations. Tax-exempt organizations account for ten percent of total employment in the United States and six percent of its GNP.

The stated policy reasons underlying the exemption for the different types of tax-exempt organizations vary, as do the requirements for exemption. The Section 501(c)(3) charitable organization is the most common type of tax-exempt organization, and it is the only type

73. I.R.C. § 501(c)(8).
74. I.R.C. § 501(c)(21).
75. I.R.C. § 501(c)(16).
76. This figure does not allow for the undercounting of small organizations which are not required to apply to the IRS for recognition of exemption and are not required to file annual information returns. I.R.C. § 508(c)(1)(A). These organizations include churches and certain affiliates. I.R.C. § 508(c)(1)(A). They also include organizations that are not private foundations within the meaning of I.R.C. § 509(a) and whose gross receipts do not normally exceed $5,000. I.R.C. § 508(c)(1)(B). Researchers estimate that the actual number of tax-exempt organizations is closer to 1.5 million. Bowen et al., supra note 1, at 4. The size of the sector is particularly impressive when it is compared with the approximately six million business organizations. Id. The number of tax-exempt organizations has increased more rapidly than that of business organizations. Hall, supra note 1, at 62. Hall reports the following progression of the number of tax-exempt organizations on file with the IRS: 12,500 tax-exempt organizations in 1940; 50,000 tax-exempt organizations in 1950; 309,000 tax-exempt organizations in 1967; and 790,000 tax-exempt organizations in 1977. Id.
77. Bowen et al., supra note 1, at 4 (citing data for 1991).
78. For a description of the differing rationales for the exemption of I.R.C. § 501(c)(7) social clubs and § 501(c)(6) trade associations, see Hopkins, supra note 55, at 297-315, 356-65.
79. The relevant portions of I.R.C. § 501 provide:
Sec. 501. (a) EXEMPTION FROM TAXATION.—An organization described in subsection (c) or (d) or section 401(1)(a) shall be exempt from taxation under this subtitle . . .

LIST OF EXEMPT ORGANIZATIONS.—The following organizations are referred to in subsection (a):

. . . .

(3) Corporations, and any community chest, fund or foundation, organized and operated exclusively for religious, charitable, scientific, testing for public safety, literary, or educational purposes, or to foster national or international amateur sports competition (but only if no part of its activities involve the provision of athletic facilities or equipment), or for the prevention of cruelty to children or animals, no part of the net earnings of which inures to the benefit of any private shareholder or individual, no substantial part of the activities of which is carrying on propaganda, or otherwise attempting, to influence legislation (except as otherwise provided in subsection (h)), and which does not participate in, or intervene in (including the publishing or distributing of statements), any political campaign on behalf of (or in opposition to) any candidate for public office.
discussed in this Article. The IRS records report 599,745 organizations that qualify for exemption under Section 501(c)(3).80

1. CHARITABLE PURPOSE

The threshold requirement under Section 501(c)(3) is that a charitable organization must be organized and operated "exclusively" for a charitable purpose.81 Section 501(c)(3) enumerates the following purposes: religious, educational, charitable, scientific, literary, testing for public safety, prevention of cruelty to children or animals, and fostering national or international amateur sports competition.82 The Regulations define the term "charitable" by reference to "its generally accepted legal sense" and provide a more expansive list of purposes that qualify under the generic term "charitable."83 Some of these purposes include: relief for the poor, advancement of religion, education or science, erection of public buildings, lessening the burdens of government, and the promotion of social welfare.84 In each case, the organization must serve a sufficiently broad charitable class of potential beneficiaries.85 It cannot

80. Tax-Exempt Organizations Registered with the IRS, CHRON. PHILANTHROPY, July 13, 1995, at 44 (reporting for 1994). Again, this does not allow for undercounting. See supra note 76 (explaining the reasons for the undercounting). Researchers estimate that the actual number is closer to 750,000 charitable organizations. BOWEN ET AL., supra note 1, at 4-5.

81. The term "exclusively" has been interpreted to mean "primarily." See Better Business Bureau v. United States, 326 U.S. 279, 286 (1945).

82. I.R.C. § 501(c)(3). With the exception of public safety testing organizations (e.g., Underwriters' Laboratory), all otherwise qualifying § 501(c)(3) organizations are entitled to receive tax-deductible contributions. I.R.C. § 170(c)(2). See infra text accompanying notes 110-18.

83. Treas. Reg. § 1.501(c)(3)-1(d)(2) (as amended in 1990). The regulations also mention the "broad outlines of 'charity' as developed by judicial decisions." Id.

84. Id. The regulations describe charitable tax-exempt purposes as follows: Relief of the poor and distressed or of the underprivileged; advancement of religion; advancement of education; advancement of science; erection or maintenance of public buildings, monuments, or works; lessening the burdens of Government; and promotion of social welfare by organizations designed to accomplish any of the above purposes, or (i) to lessen neighborhood tensions; (ii) to eliminate prejudice and discrimination; (iii) to defend human and civil rights secured by law; or (iv) to combat community deterioration and juvenile delinquency.

85. Treas. Reg. § 1.501(c)(3)-1(d)(ii) (as amended in 1990). "[I]t is necessary for an organization to establish that it is not organized or operated for the benefits of private interests such as designated individuals, the creator or his family, shareholders of the organization, or persons controlled, directly or indirectly, by such private interests." Id.
qualify for exemption if it is formed solely for the benefit of designated individuals or interests. This wide variety of purposes leads to a diverse group of organizations that qualify under Section 501(c)(3). For example, the National Taxonomy of Exempt Entities divides the charitable sector into over twenty primary industry fields and monitors information on public charities that have annual gross receipts of at least $25,000.

For example, an organization formed to defray the costs of a bone marrow transplant for a specific individual with advanced breast cancer does not qualify. However, an organization dedicated to improve the condition of individuals living with cancer would qualify because the class of the charitable recipients is broad and changing. See, e.g., American Campaign Academy v. Commissioner, 92 T.C. 1053 (1989) (educational organization that trains individuals as political campaign professionals was denied exemption because it was organized to benefit “Republican candidates and entities” that were considered to be impermissible private interests).

The National Taxonomy of Exempt Entities is a joint venture of the National Center for Charitable Statistics at the Independent Sector and the Foundation Center. See Bowen et al., supra note 1, at 20.

Organizations that qualify under § 501(c)(3) are further classified as public charities and private foundations. Congress created the classification of private foundations in 1969 in response to a demand for greater oversight of the activities of tax-exempt charitable organizations, particularly organizations started by a single donor, family, or corporation. See Senate Finance Committee, 89th Cong., 1st Sess., Treasury Dept't Report on Private Foundations (Comm. Print 1965) (stressing the need to either encourage greater public involvement in the activities of private philanthropic agencies or introduce public monitoring of their activities). Private foundations are subject to more onerous reporting requirements and excise taxes. I.R.C. §§ 4940-4945 (1995). Moreover, the tax treatment of contributions to private foundations is not as favorable as that for contributions to public charities. I.R.C. § 170(b)(1)(B), (e)(1)(ii).

All charitable organizations are presumed to be private foundations unless they meet one of the statutory exceptions. I.R.C. § 508(b). A series of very complicated rules demarcate which organizations warrant such increased scrutiny. Some organizations are considered public charities based on the type of the organization. These organizations are § 509(a)(1) public charities and § 509(a)(3) supporting organizations. I.R.C. § 509(a) (1995). Section 509(a)(1) exempts organizations described in § 170(b)(1)(A)(I)—(v) solely on the basis of the nature of the organization (e.g., churches, schools, hospitals). Section 509(a)(3) excludes organizations that are considered responsive to the public by reason of their relationship to another § 509(a)(1) public charity, including a “publicly supported” charity discussed below. Other organizations qualify based on their sources of revenue, and they fall into two categories: publicly supported charities and broadly publicly supported charities. I.R.C. §§ 170(a)(1)(A)(vi), 509(a)(2). The former must receive a significant portion of its receipts from a large number of donors. Treas. Reg. § 1.170A-9(e)(1)(i) (as amended in 1972). The broadly supported charity, however, must receive a substantial portion of its revenue from the performance of exempt functions. I.R.C. § 509(a)(2).

Public charities with annual gross receipts of less than $25,000 are not required to file an Annual Information Return of Exempt Organization, Form 990. See
2. LIMITATIONS ON ACTIVITIES

Henry Hansmann's ground breaking article on the role of the nonprofit enterprise identified the "nondistribution constraint" as the common attribute of nonprofit organizations. 90 The Internal Revenue Code expresses this constraint as the prohibition against private inurement. 91 The private inurement restriction does not mean that employees of charitable organizations must work for free. 92 A charitable

supra note 76. Private foundations must file regardless of the level of their gross receipts. 90. Henry B. Hansmann, The Role of Nonprofit Enterprise, 89 YALE L.J. 835, 844 (1980) [hereinafter Hansmann, The Role of Nonprofit Enterprise]; see also Henry B. Hansmann, The Rationale for Exempting Nonprofit Organizations from Corporate Income Taxation, 91 YALE L.J. 54, 56 (1981) [hereinafter Hansmann, The Rationale for Exempting Nonprofit Organizations]. 91. An organization only qualifies under § 501(c)(3) if "no part of the net earnings of [the organization] inures to the benefit of any private shareholder or individual." I.R.C. § 501(c)(3). The prohibition against private inurement also applies to organizations enjoying tax-exempt status under other paragraphs of § 501(c), including § 501(c)(4) social welfare organizations, § 501(c)(6) trade associations, and § 501(c)(7) social clubs. The Regulations and numerous internal IRS documents have developed an intricate body of regulatory and nonbinding advice regarding the prohibition. Generally, the prohibition against private inurement is designed to prevent individuals who are insiders from siphoning off the "net profits" of a tax-exempt charitable organization. In plain language, the IRS Exempt Organizations Handbook explains that the restriction on private inurement means "a private shareholder or individual cannot pocket the organization's funds except as reasonable payment for goods or services." INTERNAL REVENUE SERV., EXEMPT ORGANIZATIONS HANDBOOK, IRM 7751, § 381.1(4) (1994). The tax policy rationale is that individuals should not benefit from the fact that the net profits of the organization were amassed free of tax and with the assistance of tax subsidized contributions. Henry Hansmann provides an economic rationale for the restriction, arguing that it is in response to consumer demand in the face of contract failure. See infra text accompanying notes 142-47. The Regulations define the term "private shareholder or individual" to mean "persons having a personal and private interest in the activities of the organization." Treas. Reg. § 1.501(a)-1(c) (as amended in 1982). According to the IRS, this includes the following: "trustees, officers, members, founders, or contributors." INTERNAL REVENUE SERV., supra, § 381.1(4).

The statutory use of the term "shareholder" is somewhat misleading because it generally is not applicable to organizations that otherwise qualify under § 501(c)(3). Nonprofit corporations have members, but they do not have shareholders because they lack equity investors. Nonprofit corporations are typically organized on a nonmembership basis with a self-perpetuating board of directors. A nonprofit corporation may be organized on a membership basis in which case the members have the same rights as shareholders with respect to corporate governance, but they do not have equity interests in the organization.

92. World Family Corp. v. Commissioner, 81 T.C. 958, 969 (1983) ("The law places no duty on individuals operating charitable organizations to donate their services; they are entitled to reasonable compensation for their efforts.").
organization is permitted to pay reasonable compensation for goods and services.

The Internal Revenue Code imposes three additional limitations on the activities of tax-exempt charitable organizations. These restraints limit (or prohibit) the ability of charitable organizations to engage in an unrelated trade or business,\(^{93}\) lobbying, or electioneering. The following two sections explore the scope of the restrictions on lobbying and political activities.

\subsection{a. Lobbying}

Charitable organizations cannot engage in a "substantial" amount of lobbying or otherwise attempt to influence legislation.\(^{94}\) There are, however, numerous exceptions, such as a safe-harbor election which

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93. To qualify under § 501(c)(3), a charitable organization must be operated "exclusively" for charitable purposes. This limits the extent to which an organization can engage in activities that are unrelated to its charitable purpose. Although the scope of this limitation is unclear, it is generally interpreted to prohibit the existence of a substantial nonexempt purpose. \textit{See}, e.g., \textit{Steven Bros. Found. v. Commissioner}, 324 F.2d 633, 638 (8th Cir. 1963), \textit{cert. denied}, 376 U.S. 969 (1964). Whether a nonexempt purpose is "substantial" is determined by a facts and circumstances approach. \textit{See Kentucky Bar Found. v. Commissioner}, 78 T.C. 921, 923-24 (1982). Accordingly, too much unrelated business activity jeopardizes an organization's tax-exempt status. Unrelated trade or business activity can also produce tax liability because the exemption from federal income tax only applies to income that is substantially related to the organization's exempt purpose. Certain trade or business income of an exempt organization is subject to the unrelated business income tax (UBIT). I.R.C. § 511 (1995). The stated policy rationale is to prevent unfair competition. UBIT is imposed on the gross income of a trade or business less allowable deductions, provided the activity is regularly carried on and it is not substantially related to the performance of an organization's charitable purpose. Treas. Reg. § 1.513-1(c) (as amended in 1969) (defining "regularly carried on"); Treas. Reg. § 1.513-1(d) (explaining "not substantially related"). There are exceptions for a trade or business: (i) conducted by volunteers (e.g., the Girl Scout cookie sale); (ii) consisting of the sale of contributed items (e.g., a hospital thrift shop); and (iii) carried on for the convenience of the organization's members, employees, students, or patients (i.e., a hospital or university cafeteria). I.R.C. § 513(a)(1) (1995) (volunteers), (a)(3) (contributed items), (a)(2) (convenience of members). UBIT is not imposed on investment income or other types of "passive" income such as royalties, capital gains, and rent from real property. I.R.C. §§ 512(b), 514 (1995) (exempting certain "debt-financed property" from the exclusion).

94. I.R.C. § 501(c)(3) (providing "no substantial part of the activities of [the organization] is carrying on propaganda or otherwise attempting, to influence legislation"). Economists suggest that this limitation has caused reform-minded organizations to use litigation rather than legislation to achieve their goals. \textit{See} Laura B. Chisom, \textit{Exempt Organization Advocacy: Matching the Rules to the Rationales}, 63 \textit{Ind. L.J.} 201, 241-42 (1988) (citing Weisbrod et al., \textit{Public Interest Law: An Economic and Institutional Analysis} 556-57 (1978)).

\end{footnotesize}
permits charitable organizations to engage in a significant, if not substantial, amount of lobbying. The safe-harbor election requires the qualified organization to measure its lobbying expenditures under a bright-line mathematical test rather than a facts and circumstances test. When an organization "normally" exceeds its lobbying limits, the organization loses its tax-exempt charitable status.

At first glance, it appears that the lobbying restriction is directly implicated in the case studies presented in Part III. However, much of the activity described in the case studies is excluded from the definition of lobbying on two grounds. First, proposed administrative rulemaking is not legislation. Second, even appeals to Congress for legislative relief are excluded because organizations are permitted to engage in "self-defense" lobbying related to the organization's survival (e.g., matters involving tax exemption).
Commentators suggest that the limitations on lobbying by charitable organizations are too restrictive. But the organizations report that they are quite pleased with the latitude permitted under the Section 501(h) safe-harbor election. For example, The Nonprofit Lobbying Guide reassures its readers that "the law permits ample room for all the lobbying your group will probably want to undertake. It is very simple to elect to come under the provisions of [Section 501(h)]." It also boasts that the "superb lobbying regulations" were the result of a "grueling four-month battle, in which nonprofits lobbied administration officials and enlisted the support of Congress."

b. Political activities

Section 501(c)(3) imposes an absolute prohibition on political activities or electioneering. There is no safe harbor election or self-defense exemption. A charitable organization cannot support (or oppose) political candidates or parties. The prohibition applies to direct or indirect support of political candidates or parties, including contributions to political candidates or parties, expenditures in support of political candidates or parties, and other forms of political activity.

101. See, e.g., Chisolm, supra note 94 at 287 (arguing to allow lobbying by charitable organizations which corrects for market failure, specifically lobbying by "charitable" organizations with a broad base of support); Miriam Galston, Lobbying and the Public Interest: Rethinking the Internal Revenue Code's Treatment of Legislative Activities, 71 TEX. L. REV. 1269, 1274 (1993) (urging the reform of lobbying limitation to permit "educational advocacy" and thereby encourage "a more deliberative and public-regarding legislative process").

102. Practitioners' Advice to Advisers: Review Section 501(h) Election with Clients, 91 TAX NOTES TODAY 99-5, May 6, 1991, available in LEXIS, Fedtax Library, TNT File (reprinting an open letter to eligible charities noting that the election will serve the interests of the great majority of eligible § 501(c)(3) organizations).

103. BOB SMUCKER, THE NONPROFIT LOBBYING GUIDE 4 (1991). The passage continues by advising charitable organizations to take the advice they get from their attorney with a grain of salt. Mr. Smucker explains:

If you have questions about whether the amount of lobbying you want to conduct is within the law, discuss it with other nonprofits that lobby extensively, as well as with your attorney. But remember that attorneys almost always err on the side of extreme caution in counseling nonprofits about lobbying. If you ask your lawyer for advice, be certain that he or she not only knows the law well (only a few do) but, even more important, also is familiar with the experience of organizations that have lobbied under the law. Groups have found plenty of legal latitude for lobbying, without jeopardizing their tax-exempt status.

Id.

104. Id. at 19. This appeal to Congress is consistent with the case studies presented in Part III. The charitable organizations lobby Treasury and the IRS and, at the same time, appeal to Congress for a "legislative resolution."

105. I.R.C. § 501(c)(3) (an exempt organization is not permitted to "participate in, or intervene in (including the publishing or distributing of statements), any political campaign on behalf of (or in opposition to) any candidate for public office").
a candidate for public office either directly or indirectly. Political campaign contributions are completely forbidden. Even voter education initiatives run the risk of being classified as political activities.\footnote{Association of the Bar of New York v. Commissioner, 858 F.2d 867 (2d Cir. 1988), cert. denied, 490 U.S. 1030 (1989) (nonpartisan rating of candidates for judicial office constitutes a prohibited political activity); see also Priv. Ltr. Rul. 96-09-007 (Dec. 6, 1995).}

The electioneering restriction differs from the limitation on legislative activities because there is no requirement that the activity must be substantial.\footnote{Treas. Reg. § 1.501(c)(3)-1(b)(3)(i), 1.501(c)(3)-1(c)(iii) (as amended in 1990).} Theoretically, a very minor infraction can result in the revocation of an organization’s exemption. In practice, very few organizations have lost their tax-exempt charitable status as a result of political activities.\footnote{The existence of such a harsh penalty led to the push for intermediate sanctions, like excise taxes upon disqualification.} Final Regulations issued in 1995 clarify that despite the strict statutory language, an organization that corrects a prohibited activity will not lose its tax exemption.\footnote{IRS Issues Final Regulations on Excise Taxes Imposed on Political Expenditures Made by Exempt Organizations, 95 TAX NOTES TODAY 236-11, Dec. 5, 1995, available in LEXIS, Fedtax Library, TNT File. The Regulations actually relate to the imposition of excise taxes under I.R.C. § 4955 on prohibited political activities. The official explanation of the provisions state that although there is no de minimis exception, “there may be individual cases where, based on the facts and circumstances such as the nature of the political intervention,” revocation is not required. Id.} With a few

\textbf{B. Tax-Deductibility of Contributions}

Most Section 501(c)(3) organizations are entitled to receive tax-deductible contributions under Section 170.\footnote{I.R.C. § 170(c)(2). The ability to solicit tax-deductible contributions makes classification under § 501(c)(3) highly desirable. All § 501(c)(3) organizations, with the exception of public safety testing organizations, qualify to receive tax-deductible contributions under § 170(c)(2).} Section 170 permits individual and corporate taxpayers to claim a deduction for certain transfers “to or for the use” of a qualified organization.\footnote{The relevant portions of § 170 provide:

CHARITABLE CONTRIBUTION DEFINED.—For purposes of this section, the term "charitable contribution" means a contribution or gift to or for the use of—

(2) A corporation, trust, or community chest, fund or foundation—

(A) created or organized in the United States or in any possession thereof, or under the law of the United States, any State, the District of Columbia, or any possession of the United States;
minor exceptions, the organizations qualified to receive tax-deductible contributions are those described in Section 501(c)(3). In addition to a qualified donee, the transfer must constitute a "gift or contribution." This has been interpreted to require the transferor to make the transfer without the expectation of receiving a commensurate benefit in return.

The effect of the charitable deduction is to reduce the cost of giving for an individual taxpayer who itemizes his deductions. For example, an individual who transfers one hundred dollars to a qualified organization is entitled to deduct one hundred dollars from his adjusted gross income. The taxpayer saves the amount of the tax that he otherwise

(B) organized and operated exclusively for religious, charitable, scientific, literary, or educational purposes, or to foster national or international amateur sports competition (but only if no part of its activities involve the provision of athletic facilities or equipment), or for the prevention of cruelty to children or animals;
(C) no part of the net earnings of which inures to the benefit of any private shareholder or individual; and
(D) which is not disqualified for tax exemption under section 501(c)(3) by reason of attempting to influence legislation, and which does not participate in, or intervene in (including the publishing or distributing of statements), any political campaign on behalf of (or in opposition to) any candidate for public office.

In addition to exempt charitable organizations, § 170 permits a deduction for contributions to the following: U.S. instrumentalities described in § 170(c)(1), veterans' organizations described in § 170(c)(3), domestic fraternal societies described in § 170(c)(4), and cemetery companies described in § 170(c)(5).

I.R.C. § 170(c)(2).


Because the individual § 170 deduction reduces adjusted gross income, only taxpayers whose itemized deductions exceed the standard deduction receive a tax benefit from the deduction. As Gerald Schiff points out, the cost to a nonitemizer of giving one dollar remains one dollar. Schiff, supra note 1, at 11. In 1981, Congress relaxed the deductibility requirements and permitted nonitemizers to claim charitable contribution deductions. This law expired on December 31, 1986, and has not been reinstated.

Charitable contribution deductions are subject to various ceiling limitations. A taxpayer can carryover any unused portion of a contribution deduction for the following five taxable years. I.R.C. § 170(d)(1)(A). The ceiling limitations depend on the type of property contributed and the type of organization (i.e., public charity or private foundation). Generally, an individual can deduct cash contributions to public charities to the extent such contributions do not exceed 50% of his adjusted gross income. I.R.C. § 170(b)(1). The ceiling is lowered to 30% for contributions of appreciated long-term capital gain property to public charities. I.R.C. § 170(b)(1)(C). In such a case, however, the taxpayer does not recognize any gain and is entitled to deduct the full fair market value of the property, subject to the ceiling limitation. I.R.C. § 170(e)(1)(A). Less favorable rules apply to contributions of all types of property to private foundations. I.R.C. § 170(b)(1)(C). Different limitations apply to individual taxpayers and corporate taxpayers. I.R.C. § 170(b)(2) (providing a corporate taxpayer can deduct up to 10% of the corporation's taxable income without regard to any net operating loss or any capital
would have paid on that one hundred dollars of adjusted gross income. Thus, the cost of the one hundred dollar contribution is reduced by the amount of the transfer multiplied by the taxpayer’s top marginal rate of tax. If the taxpayer’s marginal rate of tax is thirty-five percent and he is able to deduct the entire amount of the contribution in the year of the transfer, then the taxpayer’s after-tax cost of the contribution is sixty-five dollars. Tax expenditure analysis characterizes the thirty-five dollar savings to the taxpayer as foregone federal revenue that is equivalent to a direct expenditure.

C. Rationales

Charitable organizations have formed a powerful interest group based on the commonality of their present legal and regulatory status. Legal commentators offer several different rationales for the exemption from tax and the deductibility of contributions. Broadly speaking, the rationales state that the twin subsidies are necessary to: (i) promote pluralism and democracy; (ii) insure the supply of collective goods in the face of market and/or government failure; and (iii) provide an accurate measure of the income tax base. Although the intricacies of the various theories are beyond the scope of this Article, it is important to have a basic understanding of the competing rationales. As described in Part III, much of the rhetorical strength of the demands of the charitable community comes from the notion that charitable organizations further pluralism and advance democratic values.

loss carryforward).

117. This can be expressed as $t(1-r)$ where $t$ equals the amount of the transfer and $r$ represents the taxpayer’s top marginal rate of tax. For example, a $1200 transfer to a qualified charity by a taxpayer in the 35% top marginal tax bracket only costs the taxpayer $780, assuming that the taxpayer is otherwise entitled to claim the full deduction. $1200(1-.35) = 780. See generally SCHIFF, supra note 1, at 11.

118. Briefly, the theory is that Congress could have collected the $35, but chose to forego the revenue in favor of subsidizing transfers to charity. For a discussion of tax expenditure analysis see infra text accompanying notes 337-48.

119. For a discussion of the interest group formation from a collective choice perspective see infra text accompanying notes 198-201.

I. PUBLIC POLICY AND PLURALISM

The public policy justification for the exemption and the deduction is based on the very strong assertion that charitable organizations produce a societal good and, therefore, their activities deserve support from the federal government in the form of favorable tax treatment.121 The universal good produced by charitable organizations is often expressed in terms of the redistributional effects of the activities of charitable organizations122 and moral considerations of altruism.123 In addition, charitable organizations are described as an integral part of the “national heritage” of the United States124 because they promote democracy and pluralism125 and lessen the burdens of government.126 The last two justifications are the rationales most often voiced by the charitable community. Democracy, pluralism, and the burdens of government are consistent themes throughout all the lobbying efforts described in Part III.

By far the most passionate arguments assert that the charitable sector plays an essential role in shaping the democratic character of

121. Bruce Hopkins, a noted tax practitioner and commentator, clearly subscribes to this view of the tax treatment of the charitable sector. Hopkins concludes his discussion of the various rationales for the favored tax treatment of charitable organizations with the following:

Consequently, it is erroneous to regard tax exemption (or, where appropriate, the charitable contribution deduction) as anything other than a reflection of this larger doctrine. Congress is not “giving” such organizations any “benefits”; the exemption (or deduction) is not a “loophole,” a “preference,” or a “subsidy”—it certainly is not an “indirect appropriation.” Rather, the various Internal Revenue Code provisions comprising the tax exemption system exist basically as a reflection of the affirmative policy of American government to not inhibit by taxation the beneficial activities of qualified exempt organizations acting in community and other public interests.

HOPKINS, supra note 55, at 13.


123. Atkinson, supra note 120, at 619 (describing the “metabenefit[s]” of altruistic production).

124. HOPKINS, supra note 55, at 5 (referring to this rationale for the exemption and the deduction as “public policy and national heritage”).

125. Atkinson, supra note 120, at 605 (noting that traditional theories posit that charitable organizations (i) “deliver goods and services more efficiently, more innovatively” and (ii) “promote pluralism and diversity”).

126. See infra text accompanying notes 132-38 (discussing the phrase “lessening the burdens of government” as a term of art used in the regulations).
contemporary American society. Proponents of this argument cite a passage in Alexis de Tocqueville's *Democracy in America* praising the diversity of voluntary associations in the United States. After discussing how charitable organizations decentralize decision-making and further pluralism by allowing the tastes of minorities to affect social policy, the proponents uniformly conclude that "organized private charitable activity continues to be more at home in the United States than anywhere else." Central to this discussion is the unspoken

127. There is some support for the notion that the charitable sector in the United States is more developed and receives more favorable tax treatment than the comparable sector in other countries. *See* CHARLES T. CLOTFELTER, FEDERAL TAX POLICY AND CHARITABLE GIVING 1 (1985) ("The non-profit sector—as distinct from government and the for-profit sector—plays a more important role in the United States than in any other industrialized economy."); HALL, supra note 1, at 2 ("American nongovernmental organizations have a special character and a crucially important function in the American polity . . . ."). Commentators point to the prevalence and influence of charitable organizations in the United States as proof that such organizations somehow contribute directly to democracy and American values.

128. It is de rigueur in any paper discussing the role of charitable organizations in American society to quote the following passage:

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

ALEXIS DE TOCQUEVILLE, DEMOCRACY IN AMERICA 115 (A.A. Knopf 1945).

129. The following quote from the introduction to a historical treatment of philanthropy is characteristic: "The story of these voluntary enterprises is the story of America at its best. Our freedom to give to such institutions or not to give—in our own way and for our own reasons—is one of the significant manifestations of the American Way of Life." ARNAUD C. MARTS, PHILANTHROPY'S ROLE IN CIVILIZATION at ix (1953).

Ironically, the claim that charitable organizations are countermajoritarian is also one of the most persistent objections to organized charity in general and the charitable contribution deduction in particular. *See*, e.g., LESTER M. SALAMON, PARTNERS IN PUBLIC SERVICE: THE SCOPE AND THEORY OF GOVERNMENT—NONPROFIT RELATIONS, IN THE NONPROFIT SECTOR: A RESEARCH HANDBOOK 99, 111-12 (Walter W. Powell ed., 1987).

130. BOWEN ET AL., supra note 1, at xxxii. Recent historical work on the origins of the charitable sector suggests that despite de Tocqueville's glowing reviews, the emergence of the charitable sector is a much more recent phenomenon. *See generally*
assumption that private charity is highly desirable and should be encouraged, at least indirectly, by the federal government.\textsuperscript{131}

Another consistent theme is that charitable organizations deserve federal support because they “lessen the burdens” of government. Actually, the phrase “lessen the burdens” is a term of art defined by the Regulations under Section 501(c)(3),\textsuperscript{132} and it is one of the many categories under which an organization can qualify under Section 501(c)(3) as a “charitable” organization.\textsuperscript{133} To qualify as tax-exempt on this basis, an organization must show: (i) an “objective manifestation” that the government considers the activity in question to be its responsibility; and (ii) evidence that the organization in fact lessens the government’s burden by assuming the activity.\textsuperscript{134}

As embraced by the charitable sector and its supporters, however, the phrase “lessening the burdens of government” has taken on a much broader meaning. In popular usage, it applies to any activity of a charitable organization regardless of whether the government would have otherwise assumed responsibility for its performance. This enables even the most progressive or alternative organization to claim that its activities meet the standard.\textsuperscript{135} Moreover, charitable organizations perform certain functions that government could not, such as religion.\textsuperscript{136}

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\textsuperscript{131} HALL, supra note 1, at 13 (“Nonprofit organizations only became a significant and ubiquitous part of the American organizational universe in the very recent past . . . .”).

\textsuperscript{132} An interesting departure from the normative model is the “donative theory” of tax exemption advanced by Mark A. Hall and John D. Colombo. They construct an exemption that depends upon the level of an organization’s voluntary support where “[d]onors ‘vote’ for an indirect subsidy by participating in a ‘market in altruism.’” Hall & Colombo, supra note 120, at 1388. The motivation for the donor’s “vote” is found in market or government failure, but the emphasis on altruism and the participation of individual donors earns the theory a mention in this section dealing with public policy.

\textsuperscript{133} The Regulations define the term “charitable” to include, inter alia, the “erection or maintenance of public buildings, monuments, or works; lessening of the burdens of Government.” Treas. Reg. § 1.501(c)(3)–1(d)(2) (as amended in 1990).

\textsuperscript{134} For a discussion of the types of charitable organizations that qualify under § 501(c)(3) see supra text accompanying notes 79–80.

\textsuperscript{135} See, e.g., Rev. Rul. 85-2, 1985-1 C.B. 178 (ruling that an organization that trained individuals to act as guardians ad litem to represent abused minors lessened the burdens of government because it performed a function that the government would have otherwise had to fulfill).

\textsuperscript{136} For example, an organization organized for the advancement for tolerance of gay men and lesbians qualifies under § 501(c)(3), provided it otherwise complies with lobbying and other restrictions. Rev. Rul. 78-305, 1978-2 C.B. 172.

\textsuperscript{136} Donna D. Alder, The Internal Revenue Code, the Constitution, and the Courts: The Use of the Tax Expenditure Analysis in Judicial Decision Making, 28 WAKE FOREST L. REV. 855, 857 (1993) (arguing that tax expenditures should be treated as subsidies under the Establishment Clause).
The claim that charitable organizations "lessen" the burdens of government was reinforced by the rhetoric that accompanied the efforts at fiscal restraint in the 1980s. In the face of budget cuts, federal policy emphasized volunteerism and private relief activities. At the same time, it praised the charitable community and institutionalized recognition of individual volunteers.

The charitable community capitalizes on its willingness to rise to the challenge presented by the decrease in federal funding for social services, the arts, and education. This perceived increase in the responsibility of charitable organizations is the fundamental feature of the argument for the maintenance of existing tax treatment of charitable organizations. Charitable organizations and their supporters argue that the federal budget policies of recent administrations have placed a terrible strain on their resources. They use this explanation to forestall any threatened regulatory change in the status of their exemption or their ability to attract tax-deductible contributions. Many take the argument one step further and use it to rationalize the increasing interest of charitable

137. For the classic statement of this proposition, see ABRAMSON & SALAMON, supra note 1, at 23-24 (citing President Reagan's belief, consistent with conservative views of government, that "a conflict exists between government and voluntary institutions and that the best way to aid the nonprofit sector is therefore to get government out of its way").

138. One example of this is President Bush's creation of the Points of Light Foundation in March 1990. The President was authorized to establish the Points of Light Foundation as an independent nonprofit organization. 42 U.S.C. § 12662(a) (1994). As a point of construction, neither the Foundation nor its officers are considered an agency or agent of the federal government. 42 U.S.C. § 12662(b). See also SCHIFF, supra note 1, at 4 ("The Bush administration has pointed to a continued, and perhaps increased, reliance on the charitable sector with its promise for a 'kinder, gentler nation'.") For a description of the Points of Light Foundation and other "government created charitable organizations" see Nancy J. Knauer, Reinventing Government: The Promise of Institutional Choice and Government Created Charitable Organizations, 51 N.Y.L. SCH. L. REV. (forthcoming 1997).

139. Independent Sector, the leading umbrella organization of charities, quotes that from 1982 to 1994, federal funding to charitable organizations was cut by $38.4 billion, assuming 1980 funding levels had been maintained. Elizabeth Greene et al., Charities and the Republican Upheaval, CHRON. PHILANTHROPY, Jan. 26, 1995, at 1, 22, 26 (describing the response to Republican proposals and noting that "at stake . . . is whether philanthropy ends up with significant new responsibilities to provide services now financed with federal money"); see also Vince Stehle & Grant Williams, Getting Ready for the 'Contract', CHRON. PHILANTHROPY, May 4, 1995, at 1 (describing the fears of Tucson charities regarding the proposed budget cuts of the 104th Congress).

140. See, e.g., infra note 222.
organizations in commercial-type activities. They then argue for relaxed rules governing the taxation of such activities.\textsuperscript{141}

2. MARKET FAILURE AND GOVERNMENT FAILURE

Henry Hansmann was the architect of the market failure explanation for both the development of tax-exempt charitable organizations\textsuperscript{142} and the justification for the exemption from federal income tax.\textsuperscript{143} He views the emergence of charitable organizations as the result of consumer preferences due to “contract failure” and explains the exemption from federal income tax as necessary governmental intervention to correct for the inability of such organizations to attract investment capital.

For Hansmann, the “nondistribution constraint” is the defining feature of the tax-exempt charitable organization.\textsuperscript{144} This refers to the prohibition against private inurement that prevents a charitable organization from distributing its earnings to private individuals.\textsuperscript{145} Hansmann theorizes that under certain circumstances the nondistribution constraint makes tax-exempt organizations more attractive to consumers. This is the case in instances of “contract failure” where consumers lack the information to evaluate the output of the organization.\textsuperscript{146} The nondistribution constraint assures the consumer that the organization will not exploit the asymmetric information to inflate profits at the expense of consumer surplus.\textsuperscript{147}

The very nondistribution constraint that inspires consumer trust makes it difficult, if not impossible, for the organization to attract

\textsuperscript{141} See Hall, supra note 1, at 80 (stating that the budget cutbacks forced charities to be more entrepreneurial); see also infra note 207.

\textsuperscript{142} Hansmann, The Role of Nonprofit Enterprise, supra note 90, at 845.

\textsuperscript{143} Hansmann, The Rationale for Exempting Nonprofit Organizations, supra note 90, at 54.

\textsuperscript{144} Id. at 56.

\textsuperscript{145} For a discussion of the prohibition against private inurement see supra text accompanying notes 90-93.

\textsuperscript{146} Hansmann identified two instances of contract failure relevant to charitable organizations. Hansmann, The Rationale for Exempting Nonprofit Organizations, supra note 90, at 69. The first involved the situation where a charity provides services to third parties, such as disaster relief. In such case, Hansmann noted that it was very difficult (and costly) for the donor/consumer to monitor the delivery of the services. The nondistribution constraint instills donor/consumer trust. Id. at 69-70. Hansmann identified the second instance of contract failure as a response to asymmetrical information, principally where the consumer lacked sufficient information to evaluate the quality of the service. Id. He noted that “[c]omplex personal services such as day care and residential nursing care” fit into this category of contract failure. Id.

\textsuperscript{147} Surgery is another example of the type of “complex personal service” subject to asymmetrical information. Id.
investment capital. Hansmann concludes that the exemption from income tax helps correct for this disadvantage because it permits a charitable organization to increase its working capital by retaining its earnings net of federal income tax.\footnote{148}

A shortcoming of Hansmann's theory is its explanation of the scope of the present exemption. As with most normative visions of the charitable sector, it does not address the current construction of the exemption.\footnote{149} The presumed inability to attract capital from investors overlooks the alternate sources of funding available to many charitable organizations.\footnote{150} These include individual and corporate contributions,\footnote{151} tax-exempt financing,\footnote{152} grants from private foundations,\footnote{153} and government contracts.\footnote{154} Many charitable organizations have sizeable endowment funds that generate tax-free investment income.\footnote{155} Moreover, many organizations such as universities and hospitals raise operating funds from the sale of services.\footnote{156}

\footnote{148} Id. at 72 (noting that the nondistribution constraint limits an organization's "access to equity capital").

\footnote{149} Hansmann's theory also overstates consumer trust and knowledge of the nondistribution constraint. Hopkins, supra note 55, at 18. (concluding that scholars such as Hansmann "overstate[] the aspect of consumer demand and downplay[] historical realities, tax considerations, and human frailties").


\footnote{151} For statistics on charitable giving see supra note 57.

\footnote{152} See infra note 168.

\footnote{153} In 1995, private foundations gave $ 10.44 billion to charitable organizations. See supra note 57.

\footnote{154} See Abramson & Salamon, supra note 1, at 62 (discussing generally the scope of the financial dependency of the charitable sector on funding from the federal government).

\footnote{155} For example, the endowment for the Shriners' Hospitals for Crippled Children is reported to be $4.8 billion. Stephen G. Greene & Grant Williams, A Question of Saving or Spending, Chron. Philanthropy, Apr. 8, 1996, at 1, 27. Even progressive organizations such as the NAACP, the Sierra Club, and the Southern Poverty Law Center have announced plans to build substantial endowments through capital campaigns. Id. (noting the controversy surrounding these decisions and accounting rules suggesting that charities should not have more than two years' operating expenses in reserve). Not all organizations share this view. HIV/AIDS organizations contend that significant reserve funds are inappropriate because of the hopefully short-term nature of the epidemic. Id. at 26. POZ, a periodical covering HIV/AIDS issues, rates the effectiveness of HIV/AIDS service organizations and considers a reserve of no more than one to two months of operating expenses to be optimal. Id.

\footnote{156} Bowen et al., supra note 1, at 140-43.
With regard to the charitable contribution deduction, commentators conclude that the tax incentive is necessary to correct for the undersupply of collective goods. 157 This theory begins with the premise that an unregulated market will undersupply collective or public goods because individuals lack incentive to contribute to the cost of such goods—the free-rider factor. 158 Generally, the cost of collective goods is constant regardless of how many consumers enjoy the goods, and once the goods are produced no one can be barred from enjoying them. 159 For example, all members of a neighborhood would benefit from the formation of a local Town Watch. It would require, however, start-up funds to buy the walkie talkies and uniforms, a commitment of administrative resources to run the program, and volunteers. When a neighbor receives a notice that a planning meeting is scheduled, the rational neighbor has no incentive to participate since he will enjoy the benefits of increased security regardless of whether he contributes any time or money to the effort. The charitable contribution deduction reduces the cost of transfers to charitable organizations to help overcome the free-rider problem and thereby help correct for the undersupply of collective goods. 160

The shortcomings of this explanation include its failure to explain the staggering amount of volunteer labor that individuals contribute to charitable organizations each year without any tax incentive. 161 It also does not explain the volume of charitable contributions from individuals who do not itemize their deductions and, therefore, receive no tax benefit from the contribution. Finally, the explanation does not justify what has been termed the “upside down” effect of the charitable contribution deduction. 162 The tax benefit created by the deduction is a function of the taxpayer’s top marginal rate of tax. Thus, higher income taxpayers

157. Clotfelter, supra note 150, at 670 (discussing “tax policy towards the voluntary sector [as] a corrective measure for a basic problem in resource allocation, namely, the undersupply of goods with beneficial externalities”).
158. Olson, supra note 24, at 16.
159. Mueller, supra note 10, at 11.
160. A refinement to this approach considers the view of the government as a “corrective institution” that supplies collective goods that are incomplete because the government can also fail to supply the desired level of collective goods. Charitable institutions are considered a response to consumer demand that cannot be met by either the private sector or the public sector. For the seminal work in the area of government failure see Burton A. Weisbrod, The Voluntary Sector: An Economic Analysis (1977). See also Weisbrod, supra note 1, 20-22 (1988).
161. A contribution of services to a charitable organization is not deductible, but out-of-pocket expenses are deductible. See Rockefeller v. Commissioner, 676 F.2d 35 (2d Cir. 1982); see also Rev. Rul. 84-61, 1984-1 C.B. 40.
162. For a more detailed discussion of this effect see infra note 347.
receive a greater tax benefit than do lower income taxpayers for the same deduction.

3. DEFINITION OF INCOME

A minority view is that the exemption from tax and the charitable deduction are simply adjustments to income consistent with the existing tax base.163 The conclusion is the anticlimactic statement that the exemption and the deduction are not tax subsidies that need to be justified. Instead, they are adjustments to income necessary to reflect the tax base accurately.

Bittker and Rahdert argue that a tax-exempt charitable organization has no income for tax purposes. Contributions to a charitable organization are excluded from its income on the same basis that gifts are excluded from gross income164 or, alternatively, that contributions to capital are excluded from the corporate income tax.165 Moreover, a charitable organization would be able to deduct most expenditures as either a charitable contribution or a reasonable and necessary business expense.166

The standard critique of this approach is that Bittker and Rahdert overstate the difficulty of measuring the income and expenses of charitable organizations.167 Moreover, voluntary contributions are not the sole, or in some cases even the dominant, source of support for charitable organizations. Many charitable organizations receive the bulk of their revenue from fees charged for services (e.g., hospitals, schools, nursing homes).168 Such organizations would not be able to exclude all of their revenue from income.

165. Id.
166. Bittker & Rahdert, supra note 163, at 304-05; 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 (Walter W. Powell ed., 1987) (discussing corporate income tax as a stopgap to the individual income tax and, therefore, not necessary in the cases where there are no equity owners as in the case of charitable organizations).
168. Id. at 59 (describing hospitals).
William Andrews uses the Haig-Simons definition of income as consumption plus net changes in wealth to reach a similar conclusion in the case of the charitable deduction. Andrews argues that the charitable contribution deduction is not a subsidy because it does not represent "private consumption" and, therefore, should not be included in the tax base under the Haig-Simons definition of income. Critics take issue with the distinction between "public" and "private" consumption. If there is no meaningful distinction between public consumption and private consumption, then all consumption expenditures should be subject to the same tax treatment, including charitable contributions.

III. THE INFLUENCE OF CHARITABLE ORGANIZATIONS ON FEDERAL TAX POLICY

In recent years, federal tax policies aimed at limiting the twin benefits of tax exemption and tax deductibility have met with concerted opposition from charitable organizations. Legislative and regulatory proposals unfavorable to charitable organizations have been reversed,

170. Id. at 369.
171. For a critique of Andrews' theory, see, e.g., Mark P. Gergen, The Case for a Charitable Contributions Deduction, 74 VA. L. REV. 1393, 1416, 1424-25 (1988) (rejecting the notion that the deduction is "intrinsic" to the income tax and questioning the ability to discern between private and public consumption).
172. Tax commentators note the influence that charitable organizations exert over the formulation and implementation of federal tax policy. Fred Stokeld, Lobbyists, Ex-Hill Staffers Deny Undue Influence on EO Division, 95 TAX NOTES TODAY 186-3, Sept. 22, 1995, available in LEXIS, Fedtax Library, TNT File. However, they differ in their assessment of whether such influence is desirable. See, e.g., Proposed Corporate Sponsorship Guidelines Defended, 93 TAX NOTES TODAY 37-86, Feb. 16, 1993, available in LEXIS, Fedtax Library, TNT File; Sponsorship Regs. Deserve Cheers Not Boos, 93 TAX NOTES TODAY 208-33, Oct. 8, 1993, available in LEXIS, Fedtax Library, TNT File. The most outspoken critic of charitable organizations' influence over tax policy is Paul Streckfus, the former Editor of Tax Analysts' The Exempt Organizations Tax Review. See, e.g., Paul Streckfus, Corporate Sponsorship Sellout Puts IRS at Risk, 93 TAX NOTES TODAY 196-79, Sept. 22, 1993, available in LEXIS, Fedtax Library, TNT File. Streckfus characterized the Proposed Regulations as a "cancer" that was "insidiously destroying what little is left of any meaningful taxation of unrelated business activity by exempt organizations," and warned that the willingness of the IRS to "back down" jeopardized "the integrity of the exempt organization function." Id.; see also Lee A. Sheppard, The Goldberg Variations, or Giving Away the Store, 93 TAX NOTES TODAY 31-17, Feb. 9, 1993, available in LEXIS, Fedtax Library, TNT File.
173. For example, after extensive lobbying by elite charitable organizations such as universities and art institutions, Congress repealed I.R.C. § 57(a)(6) which included the unrealized appreciation on long-term capital gain property contributed to charity as a
Charitable organizations lobby strenuously for the enactment of favorable legislation. Although Congress has not passed every desired piece of legislation, pro-charity tax bills have become a congressional staple.

On the regulatory side, charitable organizations stopped the implementation by the IRS of two unfavorable regulatory initiatives: the Proposed Regulations under Section 861 which impacted on the tax benefit of contributions to charitable organizations with foreign activities and the Proposed Audit Guidelines governing treatment of corporate sponsorship payments for unrelated business income tax purposes. In each case, charitable organizations used the threat of legislative action to influence the IRS and the Department of the Treasury.

This section presents the controversies surrounding the Section 861 Proposed Regulations and the corporate sponsorship rules as examples of the influence charitable organizations exert over members of Congress, the IRS, and Treasury. The cases follow a predictable course. The Department of the Treasury announces its position and then the charitable organizations respond. At the same time, the charitable organizations lobby members of Congress for a legislative solution. Congress threatens legislation and the Department of the Treasury retreats from its tax preference item for purposes of the Alternative Minimum Tax. Appreciated Property Working Group's Testimony at Ways and Means Hearing on Clinton's Economic Proposals, 93 TAX NOTES TODAY 73-59, Apr. 1, 1993, available in LEXIS, Fedtax Library, TNT File.

174. As discussed in part III.B., the Proposed Regulations under I.R.C. § 861 appear to be permanently stalled. See infra notes 202-58 and accompanying text.

175. As discussed in part III.C., the IRS reversed its early position on the taxation of corporate sponsorship payments. After an extensive public comment period, Proposed Regulations were issued that incorporated much of the commentary offered by the charitable organizations. See infra notes 259-305 and accompanying text.

176. For example, the charitable contribution deduction for nonitemizers expired at the end of 1986. Congress has refused to reinstate the deduction notwithstanding considerable pressure from charitable organizations. See infra note 196 (listing the reinstatement of the deduction for nonitemizers as a priority for the charitable organization trade association Independent Sector). In addition, the charitable contribution deduction is an itemized deduction that is subject to a partial phase-out (also referred to as an overall limitation) for high income taxpayers. See I.R.C. § 68 (1995). Charitable organizations have also been unsuccessful in their efforts to exempt the charitable deduction from the phase-out provisions. Presently, only medical expense deductions, investment interest deductions, and certain losses are exempt from the phase out. I.R.C. § 68(c).

177. Elizabeth Greene & John Murawksi, Tax Changes Loom Again for Charities, CHRON. PHILANTHROPY, Apr. 6, 1995, at 1 (describing inter alia, some of the specialized tax proposals designed to encourage giving).

178. In the controversy surrounding the § 861 Proposed Regulations, Congress took the threat of legislation one step further and attached a request for the withdrawal of the Proposed Regulations to the IRS appropriation bill. See infra notes 256-58 and
earlier position. Everyone is pleased, with the exception of a few scattered voices raised in opposition.\footnote{179} The charitable community maintains its preferred tax status and, in some instances, enhances it.

Both charitable organizations and the IRS acknowledge the ability of charities to influence federal tax policy. Charitable organizations and their representatives applaud the efforts of the IRS to establish a dialogue with the charitable community.\footnote{180} The IRS purports to welcome and, indeed, rely on input from charitable organizations when formulating relevant regulations or other guidance.\footnote{181} The obvious danger of this accompanying text.

\footnote{179}{For example, during the public comment period for the Proposed Audit Guidelines concerning the Unrelated Business Income Tax (UBIT) treatment of corporate sponsorship payments, the IRS received over 300 written responses. All but “one or two” were in favor of exempting such payments from UBIT to assist charitable organizations in raising funds. Paul Streckfus, \textit{IRS’ Pre-Inaugural Gift for Charities}, 93 \textit{TAX NOTES TODAY} 17-11, Jan. 25, 1993, \textit{available in LEXIS}, Fedtax Library, TNT File; see also infra notes 264-68 and accompanying text. This lack of balance characterizes tax policy discussions regarding charitable organizations. There is no identifiable group that will present the “other” side. Tax attorneys who specialize in representing charitable organizations generally are employed by charitable organizations and are expected to urge the adoption of policy favorable to their clients. \textit{See infra} notes 372-77 and accompanying text. An exception to this is when the small business community periodically lobbies for UBIT reform. \textit{See Small Businesses Say Nonprofits Have Unfair Advantage,} 94 \textit{TAX NOTES TODAY} 117-7, June 17, 1994, \textit{available in LEXIS}, Fedtax Library, TNT File.}

\footnote{180}{To structure this dialogue, the ABA Tax Section recommends the appointment of an Exempt Organization Counsel in the Office of Assistant Secretary of the Treasury for Tax Policy to act as a liaison to the charitable community. \textit{ABA Members Offer Exempt Organizations Compliance Suggestions,} 94 \textit{TAX NOTES TODAY} 105-25, June 1, 1994, \textit{available in LEXIS}, Fedtax Library, TNT File. This suggestion is designed to make the Assistant Secretary for Tax Policy more responsive to the needs of the charitable community. It is contrary to the nonpolitical role that Stanley Surrey envisioned for the Assistant Secretary of Tax Policy when he created the position. Stanley Surrey, \textit{The Congress and the Tax Lobbyist—How Special Tax Provisions Get Enacted,} 70 \textit{HARV. L. REV.} 1145, 1159 (1957). The Tax Section also favors a study of the feasibility of the creation of “a new and separate investigative agency . . . within Treasury to handle all EO matters.” \textit{ABA Members Offer Exempt Organizations Compliance Suggestions, supra at 105-25.}}

\footnote{181}{With respect to the UBIT treatment of corporate sponsorship payments, the IRS deviated from its standard procedures and issued the Proposed Audit Guidelines for public comment. \textit{See IRS Seeks Practitioner Help in Honing Guidelines for Corporate Sponsorship Audits,} 92 \textit{TAX NOTES TODAY} 33-20, Feb. 13, 1992, \textit{available in LEXIS}, Fedtax Library, TNT File (quoting Marcus Owens saying that the public comment period was an “unprecedented step” and noting that the “IRS does not have a complete grasp” on the sponsorship issue). Periods of public comment apply to instances of proposed rulemaking, but not to IRS-issued Audit Guidelines which are designed for internal use. \textit{See also INTERNAL REVENUE SERV., IRS EXEMPT ORGANIZATIONS CPE TECHNICAL INSTRUCTION PROGRAM TEXTBOOK} at ch. F (1993), \textit{reprinted in 94 TAX NOTES TODAY} 70-20, Apr. 12, 1994, \textit{available in LEXIS}, Fedtax Library, TNT File. The IRS explained}
new-found cooperation is that the taxing authorities only hear one side of the story. It is as if the Department of Transportation only solicited and received input from the airlines and not passengers. 182

This section does not declare that charitable organizations have "captured" 183 tax institutions. 184 Instead, it presents what has become a predictable pattern of influence where charitable organizations respond to threatened negative regulation by lobbying the IRS and the Department of the Treasury while, at the same time, seeking a legislative solution from Congress.

The case studies presented in the next subsection should be able to avoid the tautology lurking in interest group analysis because the focus of the Article is the charitable community and not the accuracy of interest group theory. 185 A consistent problem with interest group analysis is that any legislation can be interpreted as favoring some interest group 186 and, therefore, all legislation can be justified in public choice terms as

that the purpose of the comment period was to "educate the Service as to the full range of activities that might be affected by the corporate sponsorship rules" and give "concerned groups a streamlined method of determining whether they are affected." Id.

182. Paul Streckfus argues that such one-sided commentary can compromise "the integrity of the IRS exempt organization function" because the government only receives input from the members of the affected industry. Paul Streckfus, It Keeps Getting Worse, 94 TAX NOTES TODAY 128-39, July 1, 1994, available in LEXIS, Fedtax Library, TNT File.

183. For a detailed discussion of the use of the term "capture" to describe the degree of influence exercised by an interest group see generally Elhaug, supra note 6. Perhaps because evidence of "capture" is so elusive (or questionable), many scholars first identify indicia of capture and then call for empirical testing for capture. Edward Zelinsky persuasively uses this method to assess the capture of tax institutions. Zelinsky, supra note 30, at 1182-84 (identifying indicia of capture such as concentration of campaign contributions and then determining which institutions are more "capturable"). But see Allan W. Vestal, Public Choice, Public Interest, and the Soft Drink Interbrand Competition Act: Time to Derail the "Root Beer Express"?, 34 WM. & MARY L. REV. 337 (1993) (evaluating specific legislation in terms of the public choice theory and the public interest theory of legislation). This approach fails if applied to charitable organizations because the essential element of capture is exchange and charitable organizations cannot engage in exchange transactions with legislative actors. Thus, charitable organizations should be politically powerless.

184. Borrowing from Zelinsky, this Article uses the term "tax institutions" to refer to the tax committees of Congress, the Department of the Treasury, and the IRS. Zelinsky, supra note 30, at 1180.

185. See infra notes 208-305.

186. Daniel Shaviro explains: "Public choice theory inherently risks tautology, and thus lacks any rigor, because it is potentially reconcilable with almost any and all legislation. So long as someone benefits from the legislation (as is usually the case), one can claim that the beneficiary purchased it." Shaviro, supra note 40, at 75.
purchased by the interest group it favors. 187 Here, the case studies focus on what the influence reveals about the charitable sector and how it is perceived by the legislature, the IRS, and the general public. 188

A. The Formation of the Charitable Interest Group

The emergence of a coalition of charitable organizations as a distinct interest group is a relatively new phenomenon. Initial attempts to organize the charitable sector met with skepticism. 189 Writing in 1992, Peter Hall marveled at

[t]he effort to treat organizations delivering a wide variety of seemingly unrelated services—in the arts, education, health care, social welfare—as constituting a distinctive organizational sector, primarily on the basis of a set of technical criteria having to do with their status under the federal tax code, the sources and disposition of their revenues, and their manner of governance . . . 190

As the following case studies indicate, the efforts at coalition building were successful.

Charitable organizations share a common economic interest in the maintenance of their preferential tax status. In fact, tax exemption and the ability to receive tax-deductible contributions may be the only thing two charitable organizations have in common. These valuable benefits allow charitable organizations to accumulate profits for expansion, attract contributions from individuals and other funding sources, and benefit from the goodwill associated with such preferential tax status. Predictably, the major unifying factor is the maintenance (and perhaps the

187. The legislation is thus interpreted as the output purchased by whatever group it benefits, whether directly or indirectly. Id. at 122. "Legislation that helps any interest group, whether intentionally or fortuitously, becomes ostensible 'proof.' So does legislation that hurts interest groups." Id. The case studies presented in this Article do not focus solely on the legislative end result. Instead, they chart the activities of the interest group as it responds to proposed rulemaking or other agency action. They are offered to inform our understanding of the interest group, not to test the accuracy of the public choice or public interest theory.

188. For a discussion of the use of public choice or interest group theory as a diagnostic rather than a predictive tool see infra text accompanying notes 306-12.

189. See HALL, supra note 1, at 78-81 (describing the early efforts in the late 1970s to organize the charitable community around its common interests).

190. Id. at 13-14 (noting that charitable organizations "are forging awareness of themselves as distinct and coherent, particularly with regard to their legal and regulatory status ").
enhancement) of these tax benefits of exemption and deductibility of contributions.\textsuperscript{191}

Independent Sector is the leading umbrella organization of charities.\textsuperscript{192} It unified a variety of groups that sprung up in the wake of the Filer Commission.\textsuperscript{193} According to its mission statement, Independent Sector's goal is to "create a national forum capable of encouraging the giving, volunteering and not-for-profit initiative that help all of us better serve people, communities and causes."\textsuperscript{194}

Independent Sector has 800 members, forty percent of which are comprised of corporations, such as Xerox, Philip Morris Companies, Eli Lilly and Company, and foundations. The remaining sixty percent of the membership is comprised of charitable organizations.\textsuperscript{195} In addition to funding research projects, Independent Sector devotes a significant portion of its energy to lobbying members of Congress, monitoring IRS activity, and proposing legislation and rulemaking favorable to charitable organizations.\textsuperscript{196} For 1995, Independent Sector identified four major

\begin{itemize}
\item Thus, the collective action on the part of charitable organizations is to secure common economic interests. This does not raise the difficult questions involved in the case of collective action for noneconomic goals or purely public goods. Although the free-rider problem poses an obstacle to formation of an organization dedicated to preserving open space, it is much easier to account for the formation of the Independent Sector because of the shared economic interests of the participating organizations.
\item Independent Sector is a trade association for charitable organizations. \textit{Hall}, supra note 1, at 236.
\item The Filer Commission was convened in 1973 and represented a cooperative effort of Congress, the Treasury Department, and private charity. \textit{Id.} at 77. Its goal was to study incentives for giving, the regulation of charity, and alternatives to private charitable action. \textit{Id.} In 1977, the Treasury Department published the Commission's six-volume multidisciplinary survey of the role of charitable organizations in contemporary society. \textit{Id.} at 78.
\item \textit{Independent Sector}, 1994 \textit{Annual Report} 5 (1995). Its mission statement is divided into six program goal areas: public information and education, government relations, research, "give five" (i.e., promoting a national standard of giving five percent of income and five hours a week to charitable organizations), leadership and management, and creation of a "meeting ground" for the charitable sector. \textit{Id.}
\item \textit{Id.} at 13.
\item The 1994 Annual Report emphasizes the importance of vigilant monitoring of tax laws and regulations. Under "1994 Highlights," the second paragraph is captioned "Tax Battles to be Fought" and it outlines the challenges for the upcoming year. The text of the section reads:
\begin{quote}
In 1995, \textit{INDEPENDENT SECTOR}'s priority tax-issues include:
\begin{itemize}
\item Removal of charitable contributions from the current law limiting the deductions of contributions (the three percent floor).
\item Approval of the Foundation Common Fund, which would permit foundations to have a tax-exempt common investment fund, allowing pooled investments, already allowed for colleges and others.
\end{itemize}
\end{quote}
\end{itemize}
tax changes. All of them were incorporated in early tax bills. Two of them survived until the Conference Agreement where they were eliminated.197

At first glance, the formation of a coalition of charitable organizations seems to confound collective choice theory since it is hard enough relying on it to explain the formation of a single charity.198 If the free-rider impulse is problematic in the formation of a single charity, then it would seem insurmountable in the case of a coalition of charitable organizations.199 This conclusion, however, is based on a misunderstanding of the motivational force behind the creation of such organizations. Independent Sector is a trade association, not a soup kitchen. The motivations behind the successful collective action are clear economic and political incentives,200 namely ideological appeal to concepts such as pluralism and democracy.201

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* Renewal of legislation that will continue full deductibility of stock to a private foundation.
* Provide a charitable tax deduction for the 72 million non-itemizing taxpayers who presently cannot deduct their charitable contributions.

_Id._ at 23.


198. Many commentators have struggled with creating a model for the organization of individuals around noneconomic interests or purely public goods such as preserving endangered species habitats or promoting world peace.

199. To some extent this is an overstatement because the individuals involved in the organizations are self-selected. They have already resisted the impulse to free-ride and, therefore, may have developed a taste for collective action.

200. Terry Moe's discussion of the National Association of Manufacturers provides a useful comparison because the Association uses an ideological appeal to attract members and potential members. Just as the Association appeals to what has been described as the "militant defense of 'the free competitive enterprise system,'" Independent Sector is dedicated to a militant defense of the favored tax status of charitable organizations. TERRY M. MOE, THE ORGANIZATION OF INTERESTS: INCENTIVES AND THE INTERNAL DYNAMICS OF POLITICAL INTEREST GROUPS 193-99 (1980) (discussing the use of political or ideological incentives by relatively heterogeneous groups such as the National Association of Manufacturers and Chambers of Commerce, as opposed to selective incentives utilized by more narrow interest groups such as trade associations).

201. Collective choice scholars have identified various factors that overcome the impulse to free ride such as group size, the presence of entrepreneurs, selective incentives, penalties, and political motivations. For example, Olson theorized that selective incentives (i.e., private goods such as group purchasing benefits or insurance for group members) were essential to overcome the free-rider problem. OLSON, supra note 24, at 2. Although selective incentives appear significant in certain associational settings, empirical studies suggest that other factors may be more important. See DAVID KNOKE, ORGANIZING FOR COLLECTIVE ACTION: THE POLITICAL ECONOMIES OF ASSOCIATIONS 35-38 (1989) (summarizing the empirical evidence regarding selective incentives); MOE,
The case studies illustrate that strong economic incentives and ideological appeal combine to result in the formation of a formidable interest group—one that represents pluralist promises, democratic ideals, citizen participation, and superior efficiency. When a charitable organization dedicated to preserving the environment attempts to influence the course of environmental legislation (either pro or con) in a way that is consistent with its charitable purpose, it presents to the legislator a narrowly-tailored request for assistance. This is not the case when the environmental organization joins forces with international relief agencies, museums, universities, and homeless shelters. Suddenly, the request carries with it the ideological appeal of the entire charitable community.

B. Section 861 Regulations

In 1991 the Department of the Treasury issued Proposed Regulations under Section 861\(^{202}\) and unwittingly provoked a contentious response from charitable organizations engaged in humanitarian activities outside the United States. The practical effect of the Proposed Regulations is to reduce the tax benefits that United States corporations with foreign source income receive from transfers to charity where the contributions are used outside the United States. In their effort to force the Department of the Treasury to retreat from its proposed position, charitable organizations with international activities enlisted the services of lobbyists, prestigious law firms, major accounting firms, and finally members of Congress.

By all accounts, the charitable organizations' efforts were successful. Although consistent with existing tax policy, the Proposed Regulations remain stalled. As late as May 1995, the Joint Committee on Taxation gave no hint as to when, or even whether, the Proposed Regulations would be finalized.\(^{203}\)

In retrospect, 1991 was a particularly bad year for the taxing authorities to act in a way many interpreted as discouraging international humanitarian efforts. The Bush administration's Points of Light Foundation showcased volunteerism and private efforts to ease social

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\(^{200}\) supra note 200, at 193-95.


\(^{203}\) The Joint Committee on Taxation included charitable contribution deductions as "not definitely related to any gross income under the Regulations . . . (unless currently proposed regulations become final) . . . ." STAFF OF JOINT COMM. ON TAXATION, 104TH CONG., 1ST SESS., DESCRIPTION AND ANALYSIS OF CERTAIN TAX PROVISIONS EXPIRING IN 1994 AND 1995 at 50 (Comm. Print 1995).
problems. The fall of the Soviet Union marked the beginning of the "new world order" and the emergence of the United States as the only superpower. United States private humanitarian aid was sent to flood victims in Bangladesh, Kurdish refugees, and starving Somalis. By the summer of 1992, the Earth Conference in Rio focused world attention on the environmental needs of developing nations, and the relatively new "debt-for-nature swaps" seemed to hold a partial answer to the debt crises and the environmental needs of developing nations. As explained below, the Proposed Regulations threatened to reduce greatly the incentive for a corporation with foreign source income to contribute to international relief efforts and possibly to halt debt-for-nature swaps.

204. President Bush created the Points of Light Foundation in March 1990. Its purpose was to encourage volunteerism. The name is derived from his reference to 1000 Points of Light in his acceptance speech at the 1988 Republican Convention. After the creation of the organization, President Bush designated individuals as "Points of Light" in recognition of their volunteer efforts. The final "Points of Light" were designated in the last week of the Bush administration. Points of Light 1,004 to 1,020, CHRON. PHILANTHROPY, Jan. 26, 1993, at 12. See Knauer, supra note 138 (forthcoming 1997).

205. Comments opposing the Proposed Regulations stressed that it was inappropriate to introduce a disincentive for contributions for international aid when the President was asking private relief agencies to shoulder a greater burden. See infra note 222. In a letter to the Secretary of the Treasury, 48 members of Congress acknowledged that the federal government must "rely on the private voluntary sector" because it "does not have the financial resources to meet all the human, economic, environmental and other needs facing our own society, let alone the needs of other nations." Letter from 48 Members of Congress to the Secretary of the Treasury (July 31, 1991) in Charitable Allocation Rules Meet Some Congressional Opposition, 91 TAX NOTES TODAY 171-22, Aug. 15, 1991, available in LEXIS, Fedtax Library, TNT File. The letter was very conscious of the emerging international position of the United States. It stated: "There are many activities that could be jeopardized by the proposed regulation. At this very moment there are missions under way for assisting Kurdish refugees, feeding children in Africa, assisting cyclone victims in Bangladesh, and preserving the global environment through the protection of tropical rain forests." Id.


207. The innovative and much heralded debt-for-nature or debt-for-charity swaps involve a complicated three-party transfer of sovereign debt instruments payable in U.S. dollars to the account of a U.S. charity. The funds must be used to further the charitable purposes of the U.S. charity within the debtor country. See Rev. Rul. 87-124, 1987-2 C.B. 205. These debt swaps captured the interest of the charitable community and showed great promise. See Stephen G. Greene, Second Thoughts About Debt Swaps, CHRON. PHILANTHROPY, Nov. 5, 1991, at 1.
1. THE PROPOSED REGULATIONS

The Proposed Regulations interpret the application of the Section 864(e)(6) allocation and apportionment rule introduced by the Tax Reform Act of 1986. Section 864(e)(6) provides that expenses, other than interest, which are not directly allocable or apportioned to any specific income producing activity must be allocated on an affiliated group basis as if the group were one corporation. By regulation, charitable contribution deductions were "generally" considered not related to any gross income and, therefore, charitable deductions must be ratably apportioned between United States and foreign source gross income. In Notice 89-91, the IRS announced the intention to issue Proposed Regulations clarifying the allocation and apportionment of charitable contributions. The Department of the Treasury issued the Proposed Regulations after incorporating the suggestions of corporate tax experts. The Proposed Regulations reverse the position in the current


209. The intricacies of the affiliated group rules are clearly beyond the scope of this Article. The reduction in tax benefits applies to most U.S. corporations with foreign source income because most are in an excess foreign tax credit situation. See generally Allocation and Apportionment of Deductions: Regs. Sec. 1.861-8, [Foreign Income] Tax Mgmt. (BNA) No. 906 (June 24, 1996).


213. Notice 89-91 originally proposed that charitable deductions should be allocable gross-to-gross on an affiliated group basis. Commentators rejected this contention and urged the IRS to permit the allocation of charitable contribution solely to either U.S. source or foreign source income depending upon the underlying facts of the transfer. See, e.g., Tax Executives Institute, Comments on Proposed Regulations on the Allocation and Apportionment of Charitable Contributions, 43 Tax Executive 363 (1991).

214. The rules governing the allocation of charitable contributions is a small part of a much larger set of rules regarding allocations. Tax Executives Institute (TEI), an association of "corporate tax executives in North America" was instrumental in the development of the Proposed Regulations. Id. TEI argued, apparently persuasively, that charitable contributions could be traced to a particular source of income. Ironically, it was just this nexus that charitable organizations and their lobbyists so vehemently denied. In its prepared comments on Notice 89-91, TEI argued:

[C]ontributions primarily benefit only the community in which the affiliate operates. For example, corporate contributions to victims of the San Francisco earthquake or Hurricane Hugo aid only those locales, not worldwide operations. Similarly, ongoing contributions of foodstuffs to needy inner-city communities (e.g. through groups such as Second Harvest) or of computer equipment to school districts benefit the donees’ community—not the donor’s
regulations and recognize a nexus between transfers to charity and income production. The Proposed Regulations characterize a corporate transfer to charity as a purchase of goodwill in the country in which the charitable donee uses the transfer. Under this theory, a charitable deduction is allocated to United States source gross income if the taxpayer both designates and reasonably believes that the contribution will be used solely in the United States. If, on the other hand, at the time of the contribution, the taxpayer knows that the contribution either will be used solely outside the United States or may necessarily only be so used, then the taxpayer must allocate the contribution deduction to foreign source gross income.

The practical effect of allocating a deduction to foreign source income is to deny the corporate transferor with excess foreign tax credits

worldwide operations.

Tax Executives Institute, Comments on Notice 89-91: Allocation of Charitable Contributions under Section 864(e), 41 Tax Executive 567-68 (1989).

215. Kenneth W. Gideon, the then-Assistant Secretary for Tax Policy, explained that the nexus was premised on the understanding that corporate transfers to charity represent a purchase of goodwill in the locale where the transfers are used. Responding to a letter from a member of Congress, he wrote "corporate donations are intended to increase goodwill, which eventually will be reflected in increased revenue, and that such donations generally produce goodwill where they are used." Letter from Kenneth W. Gideon to Rep. Ronald K. Machlup (June 18, 1991), in Treasury Defends Allocation and Apportionment Rules for Charitable Contribution Deductions, 91 Tax Notes Today 139-32, July 1, 1991, available in LEXIS, Fedtax Library, TNT File. This observation raises the obvious question of whether a transfer that represents a purchase of goodwill qualifies as a charitable contribution under I.R.C. § 170. See Nancy J. Knauer, The Paradox of Corporate Giving: Tax Expenditures, the Nature of the Corporation, and the Social Construction of Charity, 44 DePaul L. Rev. 1 (1994) (arguing that a corporate transfer to charity represents a purchase of advertising services or public relations services and, therefore, cannot qualify for the charitable contribution deduction under I.R.C. § 170).

216. The Proposed Regulations add subsection (12) to Treas. Reg. § 1.861-8(e). Under subparagraph (i) of subsection (12), a charitable contribution deduction is allocated to U.S. source income where:

(A) The taxpayer, at the time of the contribution both designates the charitable contribution for use solely in the United States and reasonably believes that the contribution will be so used; and

(B) The contribution is not described in paragraph (e)(12)(ii) of this section [relating to charitable contribution deductions allocated solely to foreign source gross income].

Subparagraph (ii) provides that the deduction is allocated to foreign source income where:

(A) The charitable contribution will be used solely outside the United States; or

(B) The charitable contribution may necessarily be used only outside the United States.

any additional tax benefit. However, this is the result of the excess foreign tax credit situation of most domestic corporations with overseas operations and not the Section 861 allocation rules. 217 For such corporations, an additional deduction allocable to foreign source income reduces the desired tax benefit because of their excess foreign tax credit.

Charitable organizations reasoned that if taxpayers could choose between a contribution deduction allocable to United States source income or one allocable to foreign source income, the taxpayer rationally would choose the contribution allocable to United States source income because of its perceived lower marginal cost. This frightened charitable organizations with extensive international operations such as CARE, 218 the American University in Cairo, 219 and Doctors Without Borders. 220 Glossing over the finer points of international taxation, the charitable organizations saw the Proposed Regulations as a discriminatory move against organizations with overseas operations. 221 The Proposed

217. See John Turro, International Charities to Square Off on Charitable Sourcing Regs., 91 TAX NOTES TODAY 161-8, Aug. 1, 1991, available in LEXIS, Fedtax Library, TNT File ("[T]he excess foreign tax credit situation of most U.S. corporations receiving foreign income eliminates the benefits of the deduction against income derived from outside the United States.").


220. The comments of Chantral Firino Martell, executive director of Doctors Without Borders USA, noted that the organization received 25% of its funding from U.S. corporations and that the Proposed Regulations "will deal a severe blow to our fundraising efforts." Charitable Contribution Allocation Rules Would Hurt Disaster Relief Efforts, Medical Group Says, 91 TAX NOTES TODAY 151-52, July 18, 1991, available in LEXIS, Fedtax Library, TNT File (requesting the Service to adopt a rule that all contributions to U.S. charities be allocated to U.S. gross income or that at least the Proposed Regulations be withdrawn).

221. It is interesting to note how charities with entirely international operations qualify for federal tax-exemption under § 501(c)(3). A foreign organization is not entitled to receive tax-deductible contributions. I.R.C. § 170(c)(2)(A). A qualified charity,
Regulations seemed to penalize the very agencies that had assisted the Bush administration with its efforts to help Kurdish refugees, flood victims in Bangladesh, and the environmentally ravaged Eastern Europe. 222

2. RESPONSE OF THE CHARITABLE COMMUNITY

The Proposed Regulations are remarkable in their characterization of a corporate transfer to charity as a purchase of goodwill rather than the result of "detached and disinterested generosity." 223 Although many

however, may work in conjunction with a foreign charity provided such activities fall within the stated charitable purpose of the U.S. charity, and the U.S. charity has a sufficient degree of control over the use of the funds. Rev. Rul. 63-252, 1963-2 C.B. 101. This would be the case where the Board of Directors of a U.S. charity identifies and evaluates a specific project of a foreign charity, elects to help fund the project and has continuing oversight authority with respect to the use of the funds.

222. Many of the comments expressed confusion over why the Department of the Treasury would propose Regulations that would hinder international humanitarian aid in light of President Bush's emphasis on the beginning of a "New World Order." For example, a representative of World Vision wrote that the Proposed Regulations would reduce its corporate funding by $22 million. He concluded that this would have severely limited the organization's ability to respond to "the cataclysm in Bangladesh, the epic flight of the Kurdish refugees, the devastating famine of record proportions now sweeping Africa, the victims of the war in Mozambique and Sudan, and the continuing struggle to rescue the lives of the Romanian orphans." World Vision Protests Regs. Allocating Charitable Deductions, 91 TAX NOTES TODAY 113-50, May 23, 1991, available in LEXIS, Fedtax Library, TNT File; see also Charitable Deduction Changes Could Destroy Vision Assistance Group's Activities, Director Says, 91 TAX NOTES TODAY 124-17, June 10, 1991, available in LEXIS, Fedtax Library, TNT File (representative of Helen Keller International stating that the Proposed Regulations "could jeopardize the future of this agency at a time when the President and many members of Congress are calling for increased efforts to help desperately needy people throughout the world"); Foreign Trade Council Supports Exceptions to Source Allocation Regs., 91 TAX NOTES TODAY 138-43, June 28, 1991, available in LEXIS, Fedtax Library, TNT File (questioning why the government would directly hinder corporate transfers "contrary to President George Bush's April 1991 announcement of extensive humanitarian relief efforts to help alleviate the suffering of the Kurdish people in Iraq"); Hedlund, supra note 219, at 127-77 (noting that private efforts are consistent with President Bush's "Thousand Points of Light" program).

charitable organizations (and some corporate donors) took issue with the notion that a corporate transfer to charity is a purchase of goodwill, most charitable organizations attacked the Proposed Regulations on the basis that they were inconsistent with national policy.

The Proposed Regulations were released on March 12, 1991. Within weeks, the letters from concerned charitable organizations and their representatives were on their way to the IRS, Treasury officials, and members of Congress. The letter writing campaign was later joined by individuals, corporations, trade associations, the Environmental Protection Agency, and eventually members of


225. Only six weeks after the publication of the notice of proposed rulemaking, the Director of Grants Funding of MAP International, an organization that coordinates the contribution of FDA-approved medicines and supplies and distributes them to developing nations, submitted a detailed proposal to the IRS. The proposal enclosed a copy of a letter sent from the President of MAP to Senator Sam Nunn requesting an investigation of the matter. Leo C. Hiers, Allocation of Regs. Could Reduce Donations of Medical Supplies Destined for Needy Countries, 91 Tax Notes Today 113-52, May 23, 1991, available in LEXIS, Fedtax Library, TNT File (proposing the withdrawal of the proposed allocation rules or, in the alternative, an exception for the contribution of certain types of gifts-in-kind, such as medical supplies).

226. Norman W. Barr, an attorney in Texas, argued that the Proposed Regulations were unwise given that “we are attempting to feed the world [and] we need to give as much incentive as possible to companies who would contribute relief items to foreign countries in distress.” Many Letters to IRS Protest Rules Allocating Charitable Contribution Deductions, 91 Tax Notes Today 175-21, Aug. 21, 1991, available in LEXIS, Fedtax Library, TNT File. A Tax Analyst editor’s note states that the IRS received “substantially similar” letters from approximately 48 individuals. Id.

227. Dakin, supra note 224, at 150-52 (letter from senior tax counsel at Mobil Corporation requesting that he be allowed to testify at the public hearing and urging that charitable deductions should “be allocated based on where the donor makes the gift, not where the donee may use it”).

228. The National Foreign Trade Council, Inc., “an association of approximately 500 U.S. business enterprises engaged in international trade and investment,” proposed first that there should be no allocation. As an alternative, it suggested the exception of humanitarian programs supported by the U.S. government and contributions for the ill, the needy, or infants. Foreign Trade Council Supports Exceptions to Source Allocation Regs., 91 Tax Notes Today 138-43, June 28, 1991, available in LEXIS, Fedtax Library, TNT File.

229. The perceived threat to debt-for-nature swaps by the Proposed Regulations was so great that the Environmental Protection Agency submitted comments indicating that it was against the Proposed Regulations because they would chill future debt-for-nature swaps. EPA Says Charitable Allocation Regs. Conflict with U.S. Policy on Environment, 91 Tax Notes Today 150-53, July 17, 1991, available in LEXIS, Fedtax Library, TNT File (stating the Proposed Regulations are “contrary to U.S. policies to foster environmental protection in debt-burdened countries and to promote private voluntary
Congress. The electronic media made the lobbying effort very easy to follow. The IRS released copies of the letters that it received, and these letters were then published by Tax Notes Today and made available through the LEXIS database. The influential charitable organizations bar was able to monitor the events on a daily basis.

The demands of the charitable community were simple. It wanted the Department of the Treasury to withdraw the Proposed Regulations, or at least not finalize them until the charitable sector had sufficient time to "pursue a legislative resolution." Some organizations made the case for carefully tailored exceptions to the proposed rulemaking, but the majority of organizations expanded their initial request that the Treasury not enact new rules that had an unintended negative effect on corporate giving. Instead, they requested rulemaking authorizing the allocation of all charitable contribution deductions to United States source income. This was surprising because it amounted to a request for rulemaking that


231. See infra notes 372-77 and accompanying text.

232. Nonprofit Fund Advocates Change in Charitable Allocation Rules, 92 TAX NOTES TODAY 32-28, Feb. 12, 1992, available in LEXIS, Fedtax Library, TNT File (asking for a deferral of the effective date of the Proposed Regulations for "the opportunity to pursue a legislative remedy").

233. As an alternative, the charities offered several narrowly-drawn exceptions to the Proposed Regulations. The two most popular were an exception for humanitarian efforts approved or supported by the U.S. government, and an exception for certain inventory gifts for "the ill, needy, and infants." The humanitarian exception required the Secretary of the Treasury to designate certain relief efforts to be in the national interest. Foreign Trade Council Supports Exceptions to Source Allocation Regs., supra note 228, at 138-43; Tax Executives Institute, supra note 213, at 363. There is some precedent for this in the expedited review that the IRS will grant for the Exemption Applications of organizations organized in response to certain disasters (e.g., hurricanes, earthquakes, floods). The other suggestion was grounded on the public policy supporting the enhanced deduction for inventory under § 170(c) when contributed to assist in the care of "the ill, needy, or infants." Hiers, supra note 225, at 113-52.

234. See, e.g., Charitable Contribution Allocation Rules Would Hurt Disaster Relief Efforts, Medical Group Says, supra note 220, at 151-52. The Independent Sector also advocated full allocation. Group Supports Full Domestic Allocation of Charitable Contributions, 94 TAX NOTES TODAY 77-56, Apr. 21, 1994, available in LEXIS, Fedtax Library, TNT File (noting widespread support for this position among its members).
improved the existing tax treatment of charitable contributions under Section 861.\textsuperscript{235} Regardless of the strategy adopted, each organization requested a public hearing as the first order of business.

Less than one month after the date of the first letter received by the IRS, it announced that it would hold a public hearing on August 1, 1991.\textsuperscript{236} At the hearing, over thirty international charities and other interested parties testified as to the detrimental effect that the regulations would have on international humanitarian efforts. As one commentator put it, “[s]tarvation, blindness and the destruction of the rain forests are just some of the expected worldwide calamities that will result if the IRS proposed sourcing regulations on charitable contributions are finalized.”\textsuperscript{237}

Prior to the hearing, the charitable community enlisted the support of numerous members of Congress who wrote to the Commissioner of the IRS and the Secretary of the Treasury protesting the Proposed Regulations. For example, forty-eight members of Congress wrote to Secretary Brady to propose that all charitable deductions be allocated to domestic source income.\textsuperscript{238} The letter expressed in very strong terms how such a rule was grounded in “clear and convincing” public policy considerations.\textsuperscript{239} In addition, individual members of Congress expressed similar concerns and objections to the Regulations.\textsuperscript{240}

The task of responding to many of these letters fell to then-Assistant Secretary for Tax Policy, Kenneth W. Gideon. His response letters dated prior to the August 1 hearing put a pro-taxpayer spin on the

\begin{itemize}
\item \textsuperscript{235} It represents an increased benefit because, under the current regulations, charitable contributions are ratably apportioned. See supra note 211. The ratable apportion means that a portion of the tax benefit from each charitable contribution is effectively denied because of the excess foreign tax credit situation of most U.S. corporations with overseas operations. See Turro, supra note 217, at 161-8. The mandatory allocation to U.S. source income would increase the amount of the contribution deduction that could be used because none would be allocated against foreign source income.
\item \textsuperscript{236} IRS Schedules August Hearing for Regs. on Apportioning Charitable Contributions, 91 TAX NOTES TODAY 115-9, May 28, 1991, available in LEXIS, Fedtax Library, TNT File.
\item \textsuperscript{237} John Turro, International Charities Charge IRS Goofed on Proposed Charitable Sourcing Regs., 91 TAX NOTES TODAY 162-2, Aug. 2, 1991, available in LEXIS, Fedtax Library, TNT File (stating that according to the charities “the results of the Proposed Regulations will make the Old Testament sound like a travelogue”).
\item \textsuperscript{238} Charitable Allocation Rules Meet Some Congressional Opposition, supra note 230, at 171-22.
\item \textsuperscript{239} Id. The letter stated that “this point in history is a singularly inappropriate moment to take any action which would undercut the vital work of non-profit organizations active in addressing problems throughout the world.” Id.
\item \textsuperscript{240} See supra note 205.
\end{itemize}
Proposed Regulations and suggested that the new rules would actually benefit certain taxpayers.241 The letters dated after the hearing, however, were much more conciliatory. In identical letters sent to more than forty senators and representatives, Gideon assured the members of Congress that the IRS and Treasury had “no desire to harm the efforts of international relief organizations or to hinder any charitable activity,” and he seemed eager to resolve the matter in a way satisfactory to the charitable organizations.242 He closed these letters with the conclusion that the Internal Revenue Code requires the allocation and apportionment of deductions between United States and foreign source income and that “[a]s a legal matter we must find a factual relationship between a deduction and a particular stream of income to allocate the deduction [to U.S. source income].”243

Marlin Risinger, Deputy International Tax Counsel was even more explicit when he spoke at an American Bar Association Tax Section meeting eight days after the hearing.244 Risinger explained that the Department of the Treasury and the IRS were considering alternatives to the sourcing rules set forth in the Proposed Regulations. Risinger remarked: “A lot of people would like to see us go all the way to a rule that just says deduct it against your U.S. income. . . . Whether we can convince ourselves . . . that’s possible under the Code remains to be seen.”245 As soon as the hearings were concluded, it was clear that government efforts were underway to accommodate the demands of the charitable organizations.

3. LEGISLATIVE RESOLUTION AND OTHER CONGRESSIONAL ACTION

The “legislative resolution” alluded to by the charitable organizations was never enacted, but it was attempted in the form of the President’s

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241. For example, Gideon responded to Senator Lieberman’s letter to Secretary Brady. *Charitable Allocation Rules Benefit Many, Treasury Says*, 91 TAX NOTES TODAY 170-39, Aug. 14, 1991, available in LEXIS, Fedtax Library, TNT File (asserting that “the proposed rule substantially benefits many taxpayers in an excess foreign tax credit position . . . because the level of donations for domestic use is much higher”).


245. *Id.*
Tax Proposals, the Senate Amendment to the Revenue Act of 1992, and a series of charitable legislative reforms drafted by the Department of the Treasury. Evidently, Treasury was able to reconcile total allocation to domestic source income with existing law because a provision authorizing such allocation was a central feature of the Charitable Contribution Act of 1992 drafted by the Office of Tax Policy. Section Four of the Charitable Contribution Act allocated all charitable contributions to United States source income and stated that the Proposed Regulations could “substantially disadvantage charities with international activities.” The Contribution Act followed the approach taken by the President’s Tax Proposals and represented the position of the executive branch.

The Senate Finance Committee’s proposal automatically allocated a specified percentage of a taxpayer’s charitable contributions to United States source income. It then ratably apportioned the remainder between United States source income and foreign source income. The stated reason for the change was that existing law “might discourage certain taxpayers with multinational business operations from making donations to charities” and that the Proposed Regulations create “a disparity between charities on the basis of the location of their beneficiaries.” The House Bill did not include a similar provision, and the Conference Committee Bill did not incorporate the Senate Amendment.

The legislative branch, however, sent its most persuasive message to Department of the Treasury and the IRS in the form of a rebuke attached to the 1992 IRS appropriations bill. The Senate Appropriation Treasury


249. *Id.*

250. *Id.* The “Reasons for Change” also note that the pro rata rule under current law discouraged charitable giving by multinational corporations. This apparently explains the need to not only abandon the approach of the Proposed Regulations, but also to discontinue the pro rata apportionment under current law governing items of deduction not allocable to a specific source of income.

251. The original amount was 55% to U.S. source income with the remainder apportioned ratably between U.S. source income and foreign source income. This percentage division was changed in the Senate Amendment to 40% to U.S. income and 60% apportioned ratably.


253. *Id.*

Subcommittee approved a generous IRS funding bill, but at the same time issued a report criticizing the Proposed Regulations. The report concluded with the statement that "[t]he Committee urges the Treasury Department to revise these regulations and to seek methods for encouraging increased contributions to all charitable organizations whether their activities are domestic or international." The Committee reasoned that the Proposed Regulations would induce corporations to "cut back . . . contributions, jeopardizing humanitarian programs and entire organizations." The Committee further noted that "It seems particularly misguided that at a time of constantly-increasing humanitarian needs overseas, and ever increasing pressure on the federal budget that this regulation would act as a disincentive for charity." In the end, the report made who pays the bills very clear.

4. RESULT

The result of the objections voiced by the charitable community was to stall the Proposed Regulations. The IRS did not get to implement its theory of corporate transfers to charity as a purchase of goodwill. However, the charitable community did not succeed with its attempt to have all transfers allocated to United States source income. The rule regarding the allocation of charitable contribution deductions remains the same as it was prior to the issuance of the Proposed Regulations and no change is in sight.

C. Corporate Sponsorship Regulations

The controversy surrounding the taxation of corporate sponsorship payments arose after the issuance of Proposed Examination

256. Id.
257. Id.
258. Id.
259. The term "corporate sponsorship" refers to contributions to charity, either in cash or kind, that are used to support or underwrite a charity event. In 1991, corporations paid charitable organizations $1.1 billion in fees to sponsor charity events, including $64 million for the right to sponsor college football bowl games. Dennis Zimmerman, CRS Reports of Taxing Corporate Sponsorship Payments to College Bowl Games, 92 TAX NOTES TODAY 41-18, Feb. 24, 1992, available in LEXIS, Fedtax Library, TNT File; see also David A. Haimes, Corporate Sponsorships of Charity Events and the UBIT: Will Congress or the Courts Block the IRS Rush to Sack the College Football Games?, 67 NOTRE DAME L. REV. 1079 (1992).
Guidelines designed to implement the existing unrelated trade or business rules. The Guidelines clarified that a corporate sponsorship payment to a charitable organization is subject to unrelated business income tax (UBIT) where the corporate sponsor receives a substantial benefit in return. Charitable organizations saw the Guidelines as a threat to a relatively new and very lucrative source of funding—corporate sponsorship of charity events. The approach taken in the Guidelines would have reduced the after-tax value of these payments significantly. In addition, it could have forced some organizations to decline corporate sponsorship because excessive amounts of unrelated business income can jeopardize an organization’s continued qualification under Section 501(c)(3).

260. Although many charities saw the Guidelines as a radical departure from existing UBIT rules, the IRS contended that the Guidelines did not extend UBIT coverage. The 1993 Exempt Organizations CPE Technical Instruction Program Textbook explains:

The guidelines do not set forth new law; the law since the guidelines have been published is the same as before they were announced. The law is that, under certain circumstances, the corporate sponsorship income received by an exempt organization conducting public events may constitute unrelated trade or business income that is subject to tax. The guidelines provide examiners with certain indicators and analytic tools to use during examinations to evaluate the corporate sponsorship payments and make a determination as to whether the organization is engaged in an unrelated trade or business.


261. See supra note 259. The IRS noted that “[b]etween 1986 and 1991, total corporate sponsorship of sports, arts, music, community, and cause-related events has nearly tripled to $2.9 billion and the number of companies sponsoring events has doubled to 4,200 . . . .” INTERNAL REVENUE SERV., IRS EXEMPT ORGANIZATIONS CPE TECHNICAL INSTRUCTION PROGRAM TEXTBOOK at ch. O (1993), reprinted in 94 TAX NOTES TODAY 71-50, Apr. 13, 1994, available in LEXIS, Fedtax Library, TNT File [hereinafter 1993 EXEMPT ORGANIZATIONS TEXTBOOK].

262. This is because the recipient charity would be subject to UBIT on many types of sponsorship payments that were previously exempt. This would reduce the after-tax value of the payment by the charity’s top marginal rate of UBIT. Thus, a one million dollar payment to a charity in the 39.6% top marginal UBIT bracket would be worth only $604,000, after-tax. This represents the one million dollar payment less $396,000 in UBIT. Too much unrelated business income can jeopardize a charitable organization’s exemption. See supra note 93.

263. See supra note 93.
The publication of the Guidelines provoked a powerful response from the charitable community. As in the case of the Section 861 Proposed Regulations, the charitable community very quickly assembled a coordinated letter writing campaign to lobby the Department of the Treasury, the IRS, and members of Congress. But the sponsorship issue attracted a much more diverse group of charitable organizations as well as potential corporate sponsors. In addition, the taxation of corporate sponsorship payments did not have the same immediate media appeal as international humanitarian efforts. It is difficult to equate the tax-free receipt of a sponsorship payment for a college football game with the demise of corporate funding for international disaster relief. Instead, the charitable community asserted that the "new" tax burden would force charities to curtail their activities and, in some instances, go out of business entirely. With this spin, what might have seemed like an unsympathetic cause quickly became a fight for the future of the charitable community.

After three days of public hearings, the end result was the withdrawal of the Guidelines and the promulgation of Proposed Regulations which were much more favorable to charities contemplating

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266. The reaction of the charitable community was swift and corrective bills were introduced in Congress before the Mobil Cotton Bowl Technical Advice Memorandum (TAM) was made available to the public. 1993 EXEMPT ORGANIZATIONS TEXTBOOK, supra note 261, at 71-50.

Even before the memorandum [TAM 91-47-007] was made public, bills were introduced in the U.S. House of Representatives (H.R. 2464, with 99 co-sponsors currently) and in the U.S. Senate (S. 866, with 25 co-sponsors currently) which would exempt from UBIT certain types of sponsorship revenue from qualified amateur athletic event activities.

Id.

267. See infra note 286.

268. For example, the John Hancock Bowl submitted comments on the Proposed Regulations. The best it could muster for its charitable impact was that it had "provided quality entertainment and an improved quality of life for El Pasoans for 58 years." John Hancock Bowl Submits Comments on Corporate Sponsorship Guidelines, 92 TAX NOTES TODAY 163-57, Aug. 11, 1992, available in LEXIS, Fedtax Library, TNT File.
corporate sponsorships. The IRS held a second round of public comments and another public hearing on the Proposed Regulations.

1. PROPOSED TREASURY ACTION

The Guidelines followed the reasoning of a 1991 IRS technical advice memorandum269 (TAM) that classified corporate payments to a charitable organization to support a sports event as unrelated business income to the donee charitable organization.270 Although the published version of TAM 91-47-007 omitted identifying facts about the parties,271 it was commonly known that the ruling involved Mobil Oil’s sponsorship of the Cotton Bowl and the renaming of it as the Mobil Cotton Bowl.272 TAM 91-47-007 utilized a quid pro quo standard to determine whether the corporate sponsor made the sponsorship payment with an expectation of receiving substantial benefits in return.273 If so, then the payment was treated as a purchase of advertising or public relations services and was

269. Tech. Adv. Mem. 91-47-007 (Aug. 16, 1991). In TAM 91-47-007 a charitable organization renamed a college football bowl game to reflect the corporate sponsorship. When the TAM was announced, it was common knowledge that it applied to the Cotton Bowl which was renamed the Mobil Cotton Bowl. Haines, supra note 259, at 1079 n.1 (reporting that 12 of the 18 college bowl games in 1991-92 had title sponsors, including the John Hancock Bowl). TAM 91-47-007 concluded that the corporate payments to the charitable organization were subject to UBIT because the charitable organization provided a valuable good or service (i.e., advertising) to the corporate sponsor. Tech. Adv. Mem. 91-47-007, at 14.

270. The first paragraph of the Guidelines is instructive:

1. Frequently corporate donors provide financial and other support for the activities of exempt organizations. Normally this support is in the form of contributions or gifts and does not constitute any trade or business income to an organization. In certain instances, however, arrangements have been entered into with corporate sponsors that provide the sponsors with valuable marketing and other services in return for their support. Where the benefits that are provided are substantial, payments received by the exempt organization from the corporate sponsor may constitute unrelated business income subject to tax under section 511 of the Internal Revenue Code.


271. The IRS later stated that “[t]he heavily redacted version of the TAM fueled rather than assuaged [the charities'] worst fears.” 1992 EXEMPT ORGANIZATIONS TEXTBOOK, supra note 260, at 202-81.

272. Paul Streckfus, IRS National Office Dashes Cotton Bowl's Hopes for a Happy New Year, Nov. 27, 1991, 91 TAX NOTES TODAY 242-11 (“Informed sources have told Tax Analyst that Technical Advice Memorandum 9147077 was directed at the Cotton Bowl Athletic Association.”).

273. Haines, supra note 259, at 1086-87 (discussing the application in the unrelated business income tax context of the “quid pro quo” test used to determine deductibility of transfers to charity).
included in the unrelated business income of the recipient organization. 274

The charitable community began organizing even before the Mobil Cotton Bowl TAM was published. The strength of this response directly influenced the course of action followed by the IRS after the issuance of the TAM. First, the IRS issued News Release IR-92-4 to "reassure" charitable organizations that mere donor recognition would not trigger UBIT. 275 Second, the IRS incorporated its views on sponsorship payments and UBIT in the form of Proposed Examination Guidelines designed to instruct agents on what to look for in sponsorship arrangements. 276 Finally, the IRS departed from its standard procedures and added a period of public comment, issuing the Guidelines in proposed form. 277 The purpose of the comment period was "to educate the Service as to the full range of activities that might be affected by the corporate sponsorship rules." 278

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274. TAM 91-47-007 rejected an argument on the part of the charitable organization that the benefit to the corporate sponsor did not require substantial effort on the part of the charity. "[T]he relative ease . . . does not overcome the fact that [the corporation received] . . . a very valuable package of benefits," much more than "mere recognition of . . . generosity." Services Provided by Organization Produced UBIT, 91 TAX NOTES TODAY 240-18, Nov. 25, 1991, available in LEXIS, Fedtax Library, TNT File.

275. 1992 EXEMPT ORGANIZATIONS TEXTBOOK, supra note 260, at 202-81 (noting that Announcement 92-15 was issued "in direct response to the growing controversy, publicity, and misunderstandings regarding the impact of the Service's ruling on other sponsored public events"). A year later, the IRS gave a similar explanation: "In response to the confusion and concern of the exempt organization community over the recently released and heavily redacted TAM 91-47-007, the IRS used News Release IF 92-4 on January 17, 1992." 1993 EXEMPT ORGANIZATIONS TEXTBOOK, supra note 261, at 71-50.

276. Audit or examination guidelines are part of the Internal Revenue Manual. They provide instructions for the field agents and include suggestions as to what factors to consider. The IRS suggested that it might consider a greater use of Audit Guidelines in the Exempt Organization area. In addition to the corporate sponsorship guidelines, the IRS had issued guidelines for large hospital audits. Ian K. Louden, IRS May Increase Use of Guideline Approach in Exempt Area, Official Says, 92 TAX NOTES TODAY 187-15, Sept. 15, 1992, available in LEXIS, Fedtax Library, TNT File.


278. 1993 EXEMPT ORGANIZATIONS TEXTBOOK, supra note 261, at 71-50. Marcus Owens admitted that the IRS does not "have a complete grasp, or anything even approaching it" with regard to the types and scope of corporate sponsorships. Juliann Avkian-Martin, IRS Seeks Practitioner Help in Honing Guidelines for Corporate Sponsorship Audits, 92 TAX NOTES TODAY 33-20, Feb. 13, 1992, available in LEXIS, Fedtax Library, TNT File.
2. RESPONSE OF THE CHARITABLE COMMUNITY

The IRS received over three hundred comments on the Guidelines; the "greatest number of comments came from social services organizations, arts groups (including museums, theaters, ballet companies, operas and symphony orchestras), festivals and fairs, and amateur athletic associations." As was the case with the Section 861 Proposed Regulations, all but a handful of comments were opposed to the Guidelines and many were vehemently opposed to any taxation of corporate sponsorship payments. Despite the disdain for the Guidelines, many of the comments praised the IRS for soliciting the reaction of the charitable community before it issued the Guidelines in final form. The commentators interpreted this as a sign that the IRS would continue to work with the charities and ultimately resolve this issue in their favor. Almost all of the comments included a request for a public hearing, and just in the event a favorable outcome was not reached, the charities warned that they were pursuing a legislative resolution.

There was also a hint of betrayal and confusion in many of the comments. Budget cuts, the argument went, forced charities to be more enterprising, more entrepreneurial. But as soon as charitable organizations were finally able to convince corporations to act in a socially responsible way and contribute to good causes, the IRS attempted to tax the sponsorship payments. Such action was not only unfair,

279. 1993 EXEMPT ORGANIZATIONS TEXTBOOK, supra note 261, at 71-50.
280. The Center for the Study of Commercialism was the stalwart defender of the Guidelines. In fact, its comments urged the IRS to delve further into sponsorship agreements and recognize that even "mere recognition" provides a valuable benefit to the sponsoring corporation. The Center testified at both hearings. CENTER FOR THE STUDY OF COMMERCIALISM OBJECTS TO IRS GIVEAWAY, 93 TAX NOTES TODAY 96-11, May 4, 1993, available in LEXIS, Fedtax Library, TNT File (protesting the switch to the FCC standard in the Proposed Regulations); IRS NEEDS TO EXAMINE ALL PUBLIC EVIDENCE ON VALUE OF CORPORATE SPONSORSHIPS, 92 TAX NOTES TODAY 149-44, July 22, 1992, available in LEXIS, Fedtax Library, TNT File (urging the IRS to go further in the Guidelines); see also LAWYER SAYS CORPORATE SPONSORSHIP GUIDELINES ARE A GREAT IMPROVEMENT, 92 TAX NOTES TODAY 126-120, June 18, 1992, available in LEXIS, Fedtax Library, TNT File.
282. This view was also shared by officials at the IRS. Paul Streckfus, IRS' McGovern Speaks Out on Change in the Nonprofit Sector, 92 TAX NOTES TODAY 86-20, Apr. 22, 1992, available in LEXIS, Fedtax Library, TNT File (quoting Jim McGovern that as a result of the Reagan budget cuts "many nonprofits were forced to look to commercial activity to raise funds").
283. For example, Crystal Mountain Resort routinely sponsors charity ski events, and it urged the IRS to prevent the "crippling of one of the limited number of fundraising vehicles through which these worthy organizations and causes receive funding." CRYSTAL MOUNTAIN RESORT COMMENTS ON CORPORATE SPONSORSHIP GUIDELINES, 92 TAX NOTES TODAY
it was also inconsistent with national policy encouraging private charitable efforts.

After extending the comment period to accommodate the large number of interested parties who wished to comment, the IRS scheduled three days of public hearings in July 1992. The twenty-eight scheduled speakers included accounting firms, sports associations, fundraising executives, and the Coalition to Preserve Corporate Sponsorships—all of whom were opposed to the Guidelines. Many of the speakers tried to offer constructive comments, accepting the fact that the IRS would persist in its attack on corporate sponsorship payments. Two key suggestions later formed the basis of the government's response. First, the charitable community requested the issuance of Proposed Regulations in lieu of Guidelines to provide certainty of operation and "clear precedential value." Moreover, many speakers suggested that the IRS forego the quid pro quo analysis of the Mobil Cotton Bowl TAM and adopt the Federal Communications Commission (FCC) rules distinguishing between "advertising" and "acknowledgment" for public broadcast stations. Using the FCC rules, only a sponsorship payment in exchange for "advertising" services is subject to UBIT.


Announcement 92-88 scheduled three days of public hearings and further requested comments on ten specific areas of concern. These included whether there should be a safe-harbor de minimis exception, and how to allocate expenses. However, the areas of concern also included more basic questions such as how to define acknowledgment and what factors constituted advertising. Hearing Scheduled on Corporate Sponsorship Guidelines, 92 TAX NOTES TODAY 124-24, June 16, 1992, available in LEXIS, Fedtax Library, TNT File.

Seven of the 28 speakers were sports or athletic organizations, including Little League Baseball, Inc. See Avakian-Martin, supra note 265, at 148-3.

The IRS readily acknowledges that the Proposed Regulations are designed to provide the degree of certainty requested by the charitable community. 1993 EXEMPT ORGANIZATIONS TEXTBOOK, supra note 261, at 71-50.

Charities urged adoption of the FCC standards on the grounds that they represented a well-defined body of regulatory authority with which many charitable organization were already familiar. Celia Roady, Public Television Stations Submit Comments on Corporate Sponsorship Guidelines, 92 TAX NOTES TODAY 163-71, Aug. 11, 1992, available in LEXIS, Fedtax Library, TNT File; see also Juliann Avakian-Martin, IRS Ponders Using Public Broadcast Rules as a Model for Corporate Sponsorship Audit Guidelines, 92 TAX NOTES TODAY 150-6, July 23, 1992, available in LEXIS, Fedtax Library, TNT File.
3. THE PROPOSED REGULATIONS AND THE REACTION

While the response to the Section 861 Proposed Regulations merely stalled any further regulatory action, the response to the sponsorship Guidelines resulted in what even the charitable community considers success. One year after the publication of the Guidelines, the Department of the Treasury issued Proposed Regulations under which most, if not all, corporate sponsorship payments are exempt from UBIT. An IRS official described the Proposed Regulations as "a distillation of what the Service and Treasury learned as a result of the comments received. . . ." The Proposed Regulations abandon the quid pro quo analysis of the Mobil Cotton Bowl TAM and classify the services provided by the charity as either "advertising" or "acknowledgments" in accordance with FCC rules. Only payments received for "advertising" are included in the unrelated trade or business income of the charitable donee.

In response to the Proposed Regulations, there was a second public hearing held on the issue of corporate sponsorship. Eleven speakers


290. Marcus Owens, speaking to a group of museum officials, said that it would be "relatively easy" to avoid UBIT under the Proposed Regulations. Marlis L. Carson, IRS’ Owens Comments on Tax Developments Affecting Museum Operations, 93 TAX NOTES TODAY 55-13, Mar. 10, 1993, available in LEXIS, Fedtax Library, TNT File.


292. The distinction is based loosely upon the separation of the corporate sponsor from its products or services. The Proposed Regulations borrow heavily from the FCC’s rules regarding when a public television or radio station is permitted to acknowledge a sponsor in return for a payment. Prop. Treas. Reg. § 1.512(a)-1, 58 Fed. Reg. 5687, 5689 (1993); Prop. Treas. Reg. § 1.513-4, 58 Fed. Reg. 5687, 5689 (1993). The IRS explained that "[t]o the extent possible, the proposed regulations are designed to parallel the statutory and regulatory framework of the Federal Communications Commission currently in effect." Proposed Regulations Cover Exempt Organizations’ Receipt of Corporate Sponsorship Income, 93 TAX NOTES TODAY 13-1, Jan. 20, 1993, available in LEXIS, Fedtax Library, TNT File.

293. The speakers represented the American Heart Association, International Festivals Association, Coconut Grove Arts Festival, America’s Public Television Stations, National Public Radio, American Arts Alliance, Coopers & Lybrand, The Football Bowl Association, the American Institute of Certified Public Accountants, U.S. Olympic
expressed their general satisfaction with the Proposed Regulations, but urged the IRS to adopt the more favorable approach envisioned by Congress under proposed legislation.\textsuperscript{294} The legislation eliminated the distinction between acknowledgments or advertisements and focused on whether the event in question was "regularly carried on."\textsuperscript{295} The charities also urged an allocation or fragmentation rule whereby a charity could allocate a corporate sponsorship payment between acknowledgement and advertising services.\textsuperscript{296} The charities again warned of dire consequences if the Department of the Treasury did not heed their suggestions.\textsuperscript{297} Finally, the speakers requested the IRS to appoint an individual who would act as a liaison to the charitable community on the issue of compliance with the borrowed FCC guidelines.\textsuperscript{298}

4. LEGISLATIVE RESOLUTION

While the charitable community was engaged in discussion with the IRS concerning allocation and fragmentation issues, it was actively seeking legislative intervention simply to exempt all corporate sponsorship payments from UBIT. Since that time, three major sponsorship bills have been before Congress.

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\item \textsuperscript{294} The proposed legislation was H.R. 11, 102d Cong., 2d Sess. (1992). See, e.g., PGA Tour Comments on Proposed Regulations Regarding the Treatment of Corporate Sponsorship Income of Tax-Exempt Organizations, 93 TAX NOTES TODAY 151-20, July 20, 1993, available in LEXIS, Fedtax Library, TNT File.
\item \textsuperscript{295} For a description of the "regularly carried on" requirement see supra note 93.
\item \textsuperscript{296} This was referred to as the "all or nothing rule" or the "tainting provisions." The representative of the American Heart Association spoke at length about the need to include a de minimis rule to mitigate the harshness of the tainting provisions. Unofficial Transcript of IRS Hearing on Corporate Sponsorship Regs., 93 TAX NOTES TODAY 147-23, July 14, 1993, available in LEXIS, Fedtax Library, TNT File.
\item \textsuperscript{297} For example, a representative of the American Heart Association explained that the absence of a fragmentation rule would have "detrimental effects on [its] mission to reduce disability and death from cardiovascular diseases, including heart attack and stroke." Id. The representative of International Festivals, an organization that represents over 500 regional and local festivals, explained that "many of our festivals would probably go out of business." Id. The American Arts Alliance representative explained that a decrease in funding of several thousand dollars can result in the end of a small cultural organization and implored the IRS not to let "corporate fundraising become a tax mine field that chills an organization's fundraising efforts and makes compliance with the tax law very difficult unless expensive legal advice is obtained." Id.
\item \textsuperscript{298} Id.
\end{itemize}
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The first major legislative response came in the form of H.R. 11 (the "Revenue Act of 1992") and was passed by the House of Representatives before the completion of the hearings on the Guidelines. Drafted with the college bowl games in mind, it exempted from the scope of UBIT any fundraising activities that did not run for more than thirty consecutive days. It also directed the Department of the Treasury to complete a study on the corporate sponsorship of charitable athletic and cultural events. After a Senate amendment, H.R. 11 was approved by both houses in October 1992. For strictly unrelated reasons, President Bush vetoed H.R. 11 in November.

Just over a week before the hearing on the Proposed Regulations, Senator Breaux, a Democrat from Louisiana, introduced S. 1171 that was designed to clarify the exemption of corporate sponsorship payments. It followed H.R. 11 and provided exemption for the sponsorship of any activity which is related to the exempt function of the charity or which occurs annually and does not last more than thirty days. Senator Breaux explained that his bill was designed to help correct a "misguided IRS" and insure that the IRS did not "backtrack" from the pro-charity position taken in the Proposed Regulations.

By March 1995, the regulations had not yet been issued in final form and members of Congress were writing to Treasury urging the issuance of final regulations. This led to the most recent corporate sponsorship bill that is part of the Revenue Reconciliation Act, passed by both houses of the Congress, but vetoed by the President for reasons unrelated to the sponsorship provisions. The bill exempts from UBIT "qualified sponsorship payments," specifically payments where the charity agrees to use or acknowledge the name or logo of the corporate sponsor.

300. The first bill passed the House on July 2, 1992. 1993 EXEMPT ORGANIZATIONS TEXTBOOK, supra note 261, at 71-50.
301. Id.
5. RESULT

After a total of four days of public hearings and two rounds of public comments, the Proposed Regulations appear to be a victory for the charitable sector. To the extent the Guidelines had reflected existing UBIT law, the Proposed Regulations will improve the UBIT treatment of sponsorship payments. Still, the charitable sector pressed for even more favorable treatment through legislation. It remains to be seen whether the sponsorship legislation will reappear in future tax bills.305

IV. CHARITABLE ORGANIZATIONS AND TAX INSTITUTIONS

Parts II and III establish that charitable organizations have organized to preserve their preferred tax status and that they have been successful in forestalling negative regulation. This Part addresses the central question of why legislators are receptive to the lobbying efforts of charitable organizations. Its primary goal is to enhance our understanding of the charitable community, not to test the predictive ability (or prescriptive force) of either the public choice or public interest theory of legislation.306 Although academic literature often pits the public choice theory of legislation against the public interest theory,307 here they are introduced simply as diagnostic tools. The competing theories provide a framework for our analysis of the nature of charitable organizations.

The two theories pose questions at what appear to be extremes of human motivation. Public choice theory asks what charities offer the self-interested politician and public interest theory asks what charities offer the public-spirited politician. As these questions are explored, however, it becomes clear that human motivation is not so easily categorized.308 The result of the inquiry is a richer understanding of the perceived attributes of the charitable community, as well as a contextual image of the public-private continuum of human agency.

For those who are interested in testing the integrity of either theory, the conclusions reached in this section are anticlimactic. Both the public choice and the public interest theory of legislation can explain the

305. See Streckfus, supra note 172 (criticizing the Proposed Regulations as exceeding the authority of the Treasury and constituting legislation).
306. For a discussion of the perceived predictive value of public choice theory see infra text accompanying notes 323-36.
307. The traditional public interest theory of legislation contends that individuals enact (or should enact) laws and promulgate (or should promulgate) regulations to serve the public interest. See infra text accompanying notes 424-35.
308. For a discussion of the private-public continuum of human agency see infra text accompanying notes 485-503.
behavior of legislators towards the charitable community. Any initial difficulties are resolved when the charitable community is viewed in the context of its emerging relationship with the federal government and its increasing responsibility for social programs. This reinvented charitable sector has something quite compelling to offer both the self-interested and the public-spirited legislator.

Over the last fifteen years, conservative ideology and the need to cut spending and reduce the federal deficit has led policy makers to advocate shifting an ever-increasing amount of responsibility from the federal level to the state and local levels. A by-product has been an intersectoral shift in responsibility for many social programs from the federal government to charitable organizations. As a result of this reallocation of responsibility, the charitable community is not just another industry interest group. Instead, it is an integral part of the implementation of federal policy furthering deficit reduction and restraint spending.

The increased reliance on the charitable community has widespread implications, several of which are evident from the case studies presented in Part III. First, the IRS and the Department of the Treasury are increasingly solicitous of the views of the charitable community regarding the development and implementation of rules and regulations affecting the dual subsidies of tax exemption and tax-deductibility of contributions. Second, the charitable community demands durable tax subsidies and balks when agency action threatens to diminish the value of existing tax subsidies. Most importantly, the rhetorical appeal of the arguments in

309. See, e.g., Shavro, supra note 40, at 76 (suggesting that the public choice model "needs to be supplemented, not abandoned"). For a discussion of the prohibition against political activities see supra text accompanying notes 105-109.

310. These difficulties include the fact that charities should be relatively weak in a public choice world because they are prohibited from engaging in political activities. See infra text accompanying notes 398-403. In addition, the public interest theory falls a little flat given that the case studies do not reveal any sustained deliberation as to the merits of the proposed legislation. See infra text accompanying notes 438-40.

311. For a detailed discussion of the reallocation see infra text accompanying notes 482-540.

312. See infra text accompanying notes 482-503.

313. For a discussion of deficit reduction and restraint budgeting see infra text accompanying notes 482-503.

314. See infra text accompanying notes 485-96.

315. See infra text accompanying notes 441-64.

316. This was evident when the IRS broke with standard procedure and issued the corporate sponsorship Audit Guidelines in proposed form for public comment. See supra note text accompanying 277. The number of public hearings and the volume of the comments received also indicate an increased interest on the part of the IRS and the Department of the Treasury to incorporate the comments of the charitable community.
favor of the reallocation forecloses any discussion or analysis of the basic assumptions underlying the reallocation. In the rush to reduce the deficit and the size of the federal government, no one asks the fundamental questions of whether charities: (i) perform social services more efficiently than the federal government;\(^{317}\) (ii) "lessen the burdens of government" in that they provide goods the government would have otherwise supplied;\(^{318}\) and (iii) require government subsidies to perform their charitable purposes.\(^{319}\) This means that the entire reallocation rests on unexamined and unsupported assumptions, many of which are advanced by the charitable sector itself.\(^{320}\) These assumptions must be addressed before endorsing any further shift of responsibility for social programs to the charitable sector.\(^{321}\)

This section describes the public choice theory of legislation and its recent application to tax institutions.\(^{322}\) It uses the insights from interest group theory to construct a series of hypothetical quid pro quo exchanges between charities and legislators. It then briefly describes the public interest theory of legislation and examines the appeal of pro-charity legislation to the public-spirited legislator. Here, it offers a framework to begin unraveling the assumptions regarding the charitable sector.

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\(^{317}\) In this regard, there is little or no effort made to compare the government provision of collective goods or services with that of private industry. A recent poll reports that 75% of those surveyed were "confident" or "extremely confident" that charities fight poverty effectively. The confidence rating went down to 44% for state and local government and 38% for the federal government. *Poll by Center for the Study of Policy Attitudes*, CHRON. PHILANTHROPY, Dec. 13, 1994, at 15.

\(^{318}\) For a discussion of the meaning of the term "lessen the burdens of government" see *supra* text accompanying notes 132-36.

\(^{319}\) If it is the case that charities require some form of government subsidy, we still have to ask whether tax subsidies are the most efficient. For a discussion of the impact of tax policy on charitable giving see generally SCHIFF, *supra* note 1. For a discussion of the distributional impact of the favored status of charitable organizations see generally Charles T. Clotfelter, *The Distributional Consequences of Nonprofit Activities*, in *WHO BENEFITS FROM THE NONPROFIT SECTOR?* 1 (Charles T. Clotfelter ed., 1992).

\(^{320}\) Of course, before even reaching these assumptions, it is important to note that any debate about the charitable community immediately suffers from a definitional flaw because there is no attempt to differentiate among charitable organizations despite the wide variety of industry types. For an overview of the diverse group of organizations comprising the charitable sector see *supra* text accompanying notes 79-80. As explained in Part II, the only thing charitable organizations share is qualification under § 501(c)(3).


\(^{322}\) See infra text accompanying notes 323-55.
A. Public Choice Theory of Legislation

Public choice theory—"the economic study of nonmarket decision making"—views politics as a marketplace where rational actors maximize their self-interest. Public choice theory holds that in the political arena individuals are motivated by the same self-interest as is evident in the marketplace. Thus, voters, legislators, and bureaucrats act in the same rational self-interested way as do workers, investors, and managers.

323. The quote continues, "or simply the application of economics to political science." Mueller, supra note 10, at 1. Farber and Frickey adopt Mueller's definition and note that it is widely used in legal literature. Farber & Frickey, supra note 34, at 7; see also Zelinsky, supra note 30, at 1171 (quoting Dennis Mueller).

324. For a discussion of the influence of public choice theory on legal theory see Farber & Frickey, supra note 34, at 3-5 (explaining why public choice deserves serious attention in legal scholarship).

325. Public choice rejects the claim that human motivation in politics is not the same as in the marketplace. McCormick and Tollison likened this supposed duality of human nature to "the story of Dr. Jekyll and Mr. Hyde" which, although it "may make for good cinema, [is] a poor basis on which to analyze political behavior." McCormick & Tollison, supra note 24, at 5. The extent to which public choice describes human motivation as solely self-interested has been a repeated source of criticism. See generally Kelman, supra note 39 (questioning the distinction between self-interest and public interest). Even within public choice theory, the emphasis on self-interest as the sole motivator is subject to some variation. For a description of the differences between the "Chicago school" and the "Virginia school" see Michael E. DeBow & Dwight R. Lee, Understanding (and Misunderstanding) Public Choice: A Response to Farber and Frickey, 66 Tex. L. Rev. 993, 995-96 (1988).

326. This insight has far-reaching consequences regarding voter behavior, the enactment of legislation, and the influence of interest groups in the political process. As such, public choice is comprised of several branches of related yet distinct inquiry. Each of these branches posits a rational self-interested actor, whether it be a voter, legislator, or bureaucrat.

For example, the area of social choice considers the nature of voting in a democracy. This includes the innovations arising from Kenneth Arrow's observation regarding the incoherence inherent in attempts to order voter preferences. See Mueller, supra note 10, at 63-64 (explaining cycling). The notion of cycling in turn has consequences for representative democracy and even has consequences for other bodies, like the Supreme Court, where decision is by majority rule. Cycling also reveals the importance of institutional structures such as committee rules and an ability to set the agenda. A related inquiry asks why rational voters bother to vote at all given the relative unimportance of a single vote. See generally Lee, supra note 42 (describing the importance of ideology).

The interest group theory of legislation focuses on the legislator as the relevant political actor. The legislator's primary motivation is a desire to be reelected. It characterizes legislation as a product sold to interest groups who, because of collective choice constraints, are organized around narrow economic interests. See generally infra text accompanying notes 327-34.
Under the public choice or interest group theory of legislation each piece of legislation (or regulation) represents a wealth transfer. The legislator acts as a broker who matches the demand for legislation with available supply. In exchange for his or her brokerage services, the legislator receives campaign contributions or votes. Charitable organizations are prohibited from engaging in any activity, including contributions to, or endorsements of, candidates for elected office. The requisite payment for these services should preclude charitable organizations from participation in the market for regulation because they have nothing to exchange, at least not directly.

The demand for legislation is satisfied by one interest group at the expense of another interest group. Legislators have an obvious incentive to match the demand with a supply group that is diffuse and not

Public choice also addresses the role of the bureaucrat. See, e.g., William Niskanen, Bureaucracy and Representative Government (1971). The bureaucrat is motivated by a desire to maximize the bureau’s budget, since personal profit or gain is not permitted, except through illegal channels. Id. at 81. The bureau’s budget is then thought to effect the bureaucrat’s salary, and possible prestige, thereby translating into a form of personal gain. See infra text accompanying notes 489-90.

327. For the classic statement of the interest group theory of regulation see generally Peltzman, supra note 24 (formalizing Stigler’s model); Stigler, supra note 24 (theorizing that regulation is acquired by industry groups and is designed for the benefit of industry).

328. McCormick & Tollison, supra note 24, at 2.
329. Given the barriers to collective action, the demand for legislation more likely comes from concentrated interest groups (e.g., producers) and the cost is more likely borne by diffuse large groups (e.g., consumers). See generally Olson, supra note 24 (explaining the nature of collective or public goods).
330. Fred McChesney expanded the model of the legislator as passive broker to that of an active rent-seeker. Fred McChesney, Regulation, Taxes, and Political Extortion, in Regulation and the Reagan Era: Politics, Bureaucracy, and the Public Interest 233 (Roger E. Meiners & Bruce Yandle eds., 1989); see also Shaviro, supra note 40, at 64 (describing McChesney’s innovation in the model of the legislator); Robert D. Tollison, Public Choice and Legislation, 74 Va. L. Rev. 339, 361 (1988) (noting that this theory provides “insights into a range of government gestures in the direction of industry”).
331. As developed in the following section, it is possible that legislators view charities as the sum of their constituents. The vote-maximizing legislator benefits the charity in the hope of securing the loyalty of its constituents. See infra text accompanying notes 402-03.
332. Public choice theory starts with the premise that “a major portion of governmental activity is devoted to the transfer of resources among citizens.” McCormick & Tollison, supra note 24, at 15. McCormick and Tollison acknowledge that all legislation does not create a transfer of wealth, but limit their discussion to such legislation. Id. at 2.
easily identified.\textsuperscript{333} As Tollison explains, "[t]he supply of legislation is, therefore, grounded in the unorganized or relatively less-organized members of society."\textsuperscript{334}

In public choice legal scholarship, the role of the legislator has been transformed from that of a passive broker to a rent-seeking actor.\textsuperscript{335} A rent-seeking legislator strategically uses the threat of negative regulation or the promise of favorable regulation to secure interest group payments.\textsuperscript{336} This insight is particularly relevant to the case studies presented in Part III, where the charitable community responded to the threat of proposed negative regulation.

1. PUBLIC CHOICE THEORY AND TAX INSTITUTIONS

Surprisingly, there have been few applications of public choice analysis to issues of federal tax policy.\textsuperscript{337} Edward Zelinsky's recent defense of tax expenditures is a noted exception.\textsuperscript{338} His analysis is especially germane because it focuses on the interest group capture of tax institutions. However, Zelinsky's suggestion that tax institutions should be relatively resistant to interest group influence must be viewed in light of the observations set forth in Part III regarding the influence of charitable organizations over tax policy. These observations should temper any reformist impulse to embrace tax expenditures as a

\textsuperscript{333} Id. at 15, 17. The fact that legislators can identify poorly informed diffuse interest groups underscores the fact that wealth transfers are possible due to "shirking" on the part of voters. Id. at 29 (noting that the "cost" of voting for some voters makes it efficient to allow wealth to be taken away where the cost of political action exceeds the cost of the diminution in wealth).

\textsuperscript{334} Tollison, supra note 330, at 343.

\textsuperscript{335} Id. at 361. But see Shaviro, supra note 40, at n.296 (citing McCormick and Tollison and arguing that the difference is "merely semantic, since it is still the politicians and interest groups who make deals for mutual benefit at the public's expense").

\textsuperscript{336} See Doernberg & McChesney, supra note 22, at 893. McChesney's view of legislators as extortionists has met with criticism. See, e.g., Shaviro, supra note 40, at 71. Tollison notes that McChesney's theory puts a new light on "a range of government gestures in the direction of industry: for example, committee investigations and hearings, political speeches mapping out new legislative proposals, and government commissions to study 'problems.'" Tollison, supra note 330, at 361. The trade press of the charitable community and the specialty press of the tax bar actively monitor all of the above "gestures" in an attempt to identify early warning signals of impending regulation.

\textsuperscript{337} Public choice analysis of federal tax policy has been limited to discussions of the forces at work in the drafting and the passage of the Tax Reform Act of 1986. Doernberg & McChesney, supra note 22, at 891; Shaviro, supra note 40.

\textsuperscript{338} See generally Zelinsky, supra note 30 (describing tax institutions as less subject to interest group capture).
Madisonian solution to the interest group capture of direct spending programs.339

Using a "Madisonian/public choice/pluralist" analysis,340 Zelinsky reasons that congressional tax writing committees and tax institutions are less prone to interest group capture341 than single issue congressional direct spending committees or agencies. Zelinsky concludes that tax expenditures342 may at times be preferable to direct spending programs,343 particularly when a specific program would benefit from a detached and independent implementation.344

339. "Madisonian solution" is a reference to Federalist No. 10, in which James Madison warned against "factions" and sought to construct institutions resistant to such influence. THE FEDERALIST NO. 10 (James Madison).


341. Zelinsky illustrates the capture of direct spending programs by focusing on the following three factors: reliance on direct subsidies rather than tax subsidies, press coverage of direct spending programs, and congressional reliance on industry political action committee (PAC) money. Id. at 1183-84. For a larger discussion of Zelinsky's methodology see infra text accompanying notes 357-61.


343. Zelinsky is careful to stress that he is not attempting to create a "countermyth." Zelinsky, supra note 30, at 1167. Zelinsky reasons that the danger of interest group capture is not as great for tax institutions because they serve a multiplicity of constituencies. Id. at 1173; see also MUELLER, supra note 10, at 245 ("[C]ommissions that are responsible for regulating several industries are less likely to be captured by a single industry, and thus more likely to be responsive to the diffuse interests of consumers and consumer advocates."). Thus, not only are direct spending institutions less independent than previously thought, but tax institutions are more independent. Zelinsky, supra note 30, at 1180 ("Generalists inhabiting tax institutions are actually better positioned to make decisions informed by expertise because of the relative political freedom engendered by the myriad countervailing constituencies of the tax system.").

344. The preference for direct spending assumes that interest group "capture" is not desirable. Zelinsky uses interest group theory to provide a positive theory of direct spending organizations and to make the observation of capture. It is the Madisonian/pluralist spin on his argument that leads Zelinsky to conclude that tax institutions may be preferable to direct spending institutions in light of the capture of the latter.

The observed fact of interest group capture need not lead to the conclusion that it should be avoided. Tollison, supra note 330, at 341 (noting that interest group capture is not used in a pejorative sense). The charitable sector believes that the Department of the Treasury should be receptive to its needs. The charitable sector does not see this as
This assertion stands conventional wisdom on its head. Ever since Stanley Surrey popularized the tax expenditure analytical framework in the late 1960s, direct spending programs have enjoyed a presumed superiority to tax expenditures both on a substantive and a procedural basis. From a procedural standpoint, direct spending programs are narrow self-interest, but rather as advancing the interests of society because it is in the public interest to protect charity or at least not burden it with unnecessary regulation. Zelinsky also recognizes that in certain instances “capture” by a specific interest group may be desirable (e.g., veterans). Zelinsky, supra note 30, at 1175. In such a case, the institutions are simply being “responsive” to the needs of the regulated group, rather than captured by it.

Substantively, one can take issue with Zelinsky’s normative claim that tax institutions are “preferable” to direct spending institutions because the former are less subject to interest group capture. First, this assumes that interest group capture produces “bad” regulation. The preference for competition also assumes that there can be full and equal competition among interest groups. This ignores problems of collective action and assumes that all interested members of society are represented by a Madisonian “faction.” A partial response to this objection is that the monitoring of tax institutions by the general press makes information available to the general public without incurring the cost of collective action.

345. This is the case with many reforms suggested by public choice analysis. See, e.g., FARBER & FRICKEY, supra note 34, at 75-76 (noting that public choice theory favors interstate competition because it deters rent-seeking legislation, thereby turning the traditional argument for government intervention to stop interstate competition, like minimum wage laws, “on its head”).

346. The revealed shortcomings of tax expenditures are now standard fare for every introductory casebook in taxation. See, e.g., MICHAEL J. GRAETZ & DEBORAH H. SCHENK, FEDERAL TAXATION: PRINCIPLES AND POLICIES 44-58 (3d ed. 1995); WILLIAM A. KLEIN & JOSEPH BANKMAN, FEDERAL INCOME TAXATION 24 (10th ed. 1994). Tax expenditures disproportionately benefit high income taxpayers and preclude the participation of nontaxpayers. STANLEY S. SURREY & PAUL R. MCDANIEL, TAX EXPENDITURES 72 (1984). Tax expenditures complicate an already Byzantine tax structure and frustrate attempts at tax simplification. Tax institutions lack expertise and, therefore, are less efficient than direct spending programs. Simply put, the consensus has been that Congress should not attempt to do indirectly through the tax system that which it can do directly through the appropriate government agency.

347. Zelinsky categorizes the standard criticisms of tax expenditures as either substantive or procedural. This Article follows these distinctions. From a substantive standpoint, tax expenditures are considered inequitable due to their “upside down” nature. SURREY & MCDANIEL, supra note 346, at 72. But see Edward J. Zelinsky, A Response to Professor Yorio, 55 FORDHAM L. REV. 885 (1987) (defending tax expenditures from a substantive position). For example, the tax savings generated by a charitable contribution deduction is a function of a taxpayer’s top marginal rate of tax. Thus, the deduction results in a greater tax savings for high income taxpayers than for low income taxpayers. Nontaxpayers (i.e., individuals whose adjusted gross income does not exceed the standard deduction) do not share in the tax savings or participate in the direction of the tax expenditure budget. SURREY & MCDANIEL, supra note 346, at 87 (defining “nontaxpayers” to include individuals whose adjusted gross income falls below taxable
considered more efficient because, inter alia, they are developed and implemented by institutions possessing substantive expertise in the area subject to the regulation.\footnote{348}

Although public choice theory is charged with "democracy bashing,"\footnote{349} Zelinsky's Madisonian/public choice/pluralist observations have an optimistic and even reassuring ring.\footnote{350} The existence of multiple constituencies and competing interest groups in the tax system creates a competitive market for regulation where it is less likely that a single interest will dominate. Thus, the substantive expertise of direct spending institutions is an illusion, hopelessly compromised by the dominance of the regulated industry.\footnote{351} Tax institutions emerge as a preserve of pluralism.\footnote{352}

\footnote{348} In the case of an itemized deduction, a nontaxpayer would also include an individual whose itemized deductions do not exceed the standard deduction. To illustrate, assume that four individuals each transfer $100 to a qualified charity. The first taxpayer is in the 35\% top marginal rate, the second is in the 15\% top marginal rate, the third is in the 35\% top marginal rate but does not itemize his deductions, and the fourth is a nontaxpayer because his tax liability does not exceed the standard deduction. The tax expenditure for the first taxpayer is $35 compared with $15 for the second taxpayer. Neither the third nor the fourth taxpayer receives any benefit from the tax expenditure for charitable contributions.

\footnote{349} From a procedural standpoint, tax expenditures are considered less efficient than direct spending programs because tax institutions are run by generalists who lack the expertise possessed by their counterparts in direct spending institutions. STANLEY S. SUKEREY, PATHWAYS TO TAX REFORM 126-54 (1973). For example, it is inefficient to charge tax specialists with crafting and implementing a program designed to subsidize low income housing when low income housing experts are available in the appropriate direct spending congressional committees and regulatory agency.

\footnote{350} \textit{See generally} Kelman, supra note 39 (referring to "democracy bashing").

\footnote{351} \textit{Id.} at 1178 ("The theoretical skill of direct spending organizations is of little practical significance when the clientele of such organizations effectively dominate them and their decisions."). Zelinsky concedes that direct spending programs may possess a certain level of expertise, but he adds that they may not be in a position to use that expertise independently due to interest group capture. \textit{Id.} Thus, the preference for direct spending programs must be tempered by the recognition that single constituency direct spending institutions are susceptible to interest group capture which in turn compromises the institution's ability to exercise its expertise in a detached and independent manner. \textit{Id.} at 1187 (noting "a commonplace among students of American government that an interest group's control of an administrative agency affects the final outcome of the political process in ways favorable to that group").

\footnote{352} Zelinsky does not replace a preference for direct spending with a preference for tax institutions. Instead, he argues that a "trade-off" between expertise and independence based on the assumption that competition among interest groups is desirable because it can alleviate certain dangers such as logrolling. \textit{Id.} at 1190. Thus, tax
The influence of charitable organizations over federal tax policy is consistent with Zelinsky's view that tax expenditures should be viewed as a "limited resource."235 It confirms his concern that increased reliance on tax institutions will result in a corresponding increase in interest group activity.234 This is because charitable organizations owe their very status as an interest group to the Internal Revenue Code.235 It makes sense that such organizations would focus on tax policy.

2. THE MECHANICS OF CAPTURE236

The two prime components of interest group capture237 are the ability to monitor the target institution and the exchange of value (e.g., political contributions) for beneficial regulation, or the absence of expenditures should be preferred when there is a need for detached administration of policies. Id. In addition, Zelinsky notes that his argument should provide a "counterbalance" to prevailing notions about tax expenditures. Id.

Beyond this preference, Zelinsky does make two substantive claims. He questions the propriety of judicial deference to agency action. Id. at 1192. In addition, Zelinsky concludes that Establishment Clause jurisprudence which differentiates between the direct subsidy of religion and tax exemption subsidies is "more compelling procedurally than . . . commentators believe" because tax institutions are not in danger of capture by religious groups. Id. at 1193-94. However, religious organizations constitute a very strong subset of charitable organizations. Accordingly, this latter claim is questionable in light of the evidence in this Article that charitable organizations influence the implementation and regulation of rules relating to tax exemption and the ability to receive tax-deductible contributions.

353. Id. at 1191 (warning that tax expenditures are a "limited resource" and discussing the possibility that concentrated use of tax policy solutions could lead an affected industry to focus its efforts on tax institutions).

354. If interest groups focus on tax institutions as a way to secure benefits, then tax expenditures would predominate in certain industries. Id. ("If the code is the preferred instrument of special interests, we would anticipate that such interests receive a higher ratio of tax benefits to direct monetary outlays.").

355. See supra part III. The case studies show how a sector united by common tax status will focus its energy on tax institutions. This observation alone should temper any reformist impulses to embrace tax institutions as a solution to the perceived danger of interest group capture.

356. Zelinsky's insights regarding the political nature of tax institutions are particularly relevant to the present discussion. This section on the mechanics of capture adopts the basic structure used by Zelinsky to examine the influence of charitable organizations over the formulation and implementation of federal tax policy.

357. Elhauge provides the following summary of the interest group theory of legislation: "Legislators are disproportionately influenced by organized interest groups and thus enact legislation enabling those groups to extract economic rents from others. Agencies tend to be captured by the firms they regulate and thus promulgate regulations to benefit those firms even though the regulations are inefficient and exploit consumers." Elhauge, supra note 6, at 32.
negative regulation. Zelinsky identifies three different indicators to support his thesis that tax institutions are less captureable than direct spending institutions: (i) the relative coverage of tax matters and direct spending programs in both the trade press and the general press; (ii) the level of tax subsidies versus direct subsidies in four key industries; and (iii) the dependence of certain congressional members on interest group PAC money.\footnote{358}

If one used the indicators to predict instances of interest group influence, one would never identify charitable organizations as a potentially powerful interest group because only the first indicator is applicable to charitable organizations.\footnote{359} The charitable community and its trade press devote considerable resources to monitoring congressional and IRS activities concerning tax exemption and the deductibility of contributions. The two remaining factors, however, do not apply to charitable organizations. This is because, unlike the oil industry or the farm lobby, the heterogeneous members of the charitable community do not share a common interest in a single direct spending program.\footnote{360} Thus, it is not possible to compare the level of tax subsidies enjoyed by the charitable community with a single source of direct subsidies also enjoyed by the community. Moreover, charitable organizations are not permitted to participate in political campaigns,\footnote{361} so there are no charitable PACS.

\textit{a. Monitoring}

Information is central to an interest group’s ability to influence a particular government institution.\footnote{362} The interest group must know when there is an opportunity for beneficial regulation or a threat of negative regulation and it must be able to evaluate the performance of a particular legislative or regulatory actor. Trade publications are natural settings for this type of monitoring. The lack of interest on the part of the general press is an important co-factor because interest group

\begin{footnotes}
\footnote{358}{Zelinsky, supra note 30, at 1167.}
\footnote{359}{Scholars who recognize the limitations of the self-interested model nonetheless continue to value the public choice model for its "predictive" ability. Vestal, supra note 183, at 386. Here, the public choice theory would disappoint because it would never predict that charitable organizations would exercise influence over tax institutions.}
\footnote{360}{This is because charitable organizations do not share a common industry. See supra text accompanying notes 86-87.}
\footnote{361}{See supra text accompanying notes 105-09.}
\footnote{362}{Information is important because interest groups exploit asymmetrical information.}
\end{footnotes}
influence flourishes where there is a lack of generally disseminated information, making oversight more costly.\footnote{363} To illustrate how industry monitors tax institutions, Zelinsky reviewed the trade press of four different industries.\footnote{364} With one exception, he found that the relevant industrial trade press was significantly more likely to cover direct spending issues than tax issues.\footnote{365} Zelinsky attributes the increased coverage of direct spending issues in the trade press to greater industry interest.\footnote{366} Conversely, the general public is more interested in tax matters, thereby explaining why general circulation newspapers devote more coverage to tax matters than single issue direct spending programs.\footnote{367} Zelinsky concludes that "trade publications facilitate monitoring of direct expenditure processes by specialized clienteles while the general media provides tax institutions with broader visibility to the public as a whole."\footnote{368}

In the case of charitable organizations, both the general press and the charitable trade press routinely report on tax issues. The charitable sector, however, intensely monitors the activities of tax institutions on matters relating to tax exemption and the deductibility of contributions. This is predictable given the tax-based nature of the sector and the fact that it is not dependent on a single direct spending agency. For example, a major trade magazine of the charitable sector, \textit{The Chronicle of Philanthropy}, provides extensive coverage of issues related to tax exemption and the deductibility of contributions. It very closely monitors IRS activities, tax court cases, proposed legislation and rulemaking, informal IRS opinions, and presidential proposals. Its coverage of tax issues is constant, sophisticated, and pro-active.

A review of forty-one recent issues of the bimonthly publication shows that, on average, 12.89\% of the articles in each issue concern

\footnote{363. Zelinsky points to the apparent indifference of the general press regarding the activities of direct spending programs as evidence of capture. Zelinsky, \textit{supra} note 30, at 1179.}
\footnote{364. Zelinsky compared the press coverage of the two tax writing committees in Congress with that of six direct spending committees using three papers of general circulation and trade publications of the farm, oil and gas, and transportation industries. \textit{Id.} at 1184. With one exception, Zelinsky noted that the general circulation papers carried more articles concerning the tax writing committees and the trade press carried more articles concerning the relevant direct spending committees. \textit{Id.}}
\footnote{365. The one exception was the oil and gas industry. Zelinsky referred to this as the exception that proved the rule. \textit{Id.}}
\footnote{366. \textit{Id.}}
\footnote{367. \textit{Id.}}
\footnote{368. Shaviro, \textit{supra} note 40, at 96-98 (noting the importance of the media); Zelinsky, \textit{supra} note 30, at 1184.}
federal tax matters. In fact, The Chronicle of Philanthropy has a regular feature entitled "Tax Watch." It also has a regular feature describing pending legislation and proposed rulemaking. The advertisement for subscriptions promises that the Chronicle is "the one sure way to stay up to date on all the latest news affecting you and your enterprise, the newest fund-raising techniques and IRS regulations, foundation and corporate grants, deadlines, conferences and workshops, [and] ideas on management and boards."371

The specialty press of the tax bar also monitors the activities of tax institutions. Each morning thousands of tax practitioners turn on their computers and scan the latest issue of Tax Notes Today and other similar publications. The pages of Tax Notes Today contain the President's schedule, excerpts from important speeches by various political and bureaucratic actors, reprints of letters to the IRS, as well as the more mundane private letter rulings, court decisions, and proposed regulations. In both of the case studies described in Part III, tax practitioners played an important role in the lobbying efforts of charitable organizations, and it was probably tax practitioners who first sounded the alarm when there was a threat of negative regulation. Tax lawyers testified at the hearings, submitted comments on behalf of their charitable clients, wrote comments in their individual capacity, and no doubt ghost wrote some of the letters purportedly sent by

369. This percentage is based on a review of 41 issues of the Chronicle of Philanthropy from September 8, 1992 to July 13, 1995. Each issue had an average of 32 articles, of which slightly over four articles were devoted to issues of federal taxation. This percentage does not include articles concerning state and local taxation, other subsidies such as reduced postal rates, and general articles regarding the mood of Congress. The total percentage of articles dealing with federal tax matters was 12.88%. 370. The Chronicle of Philanthropy also carries a number of articles dealing with either state or local tax exemption. These articles are not included in the total. 371. See, e.g., Chron. Philanthropy, June 15, 1995, at 50 (emphasis added). 372. Publishers such as Tax Analysts, BNA, RIA, and Warren, Gorham & Lamont produce daily, weekly, and monthly tax publications, as well as other specialty tax publications geared toward tax practitioners. 373. For example, the March 11, 1996, issue of Tax Notes Today contained several news stories about different flat tax proposals, advice from an IRS official that charities should "sit out the election," summaries of recent decisions, notices that the IRS is correcting typos in regulations, IRS rulings and other documents, and congressional news releases. See generally 96 Tax Notes Today 49-C, Mar. 11, 1996, available in LEXIS, Fedtax Library, TNT File. 374. See supra note 227. 375. See supra note 225. 376. See supra note 226.
charitable organizations. In both of the case studies, Tax Notes Today and other tax publications detailed the unfolding drama on a daily basis.377

b. Influence through exchange

The public choice theory of legislation posits a political marketplace inhabited by self-interested actors. The overriding goal of the self-interested legislator is to maximize his or her chances of reelection.378 Once the interest group possesses the requisite information concerning the target, it exercises influence over the target institution through a series of quid pro quq transactions designed to appeal to this goal.

To increase the chances of reelection, a legislator engages in a variety of strategies such as “pork-barrel” legislation,379 “logrolling,”380 and constituent casework.381 The appeal of pork-barrel legislation rests on the assumption that voters support a legislator who increases economic wealth in the community.382 Typically, pork barrel projects involve concentrated benefits, such as the building of a dam, but impose diffuse costs throughout the tax system. Logrolling is vote trading with other legislators to secure support for such pet projects.383 Tollison expressed the sentiment of logrolling as “[v]ote for my dam, and I’ll vote for your port.”384 Thus, pork barrel projects are not usually built without logrolling. Constituent casework occurs when legislators intervene in the regulatory process and “cut through the red

377. Tax lawyers (and accountants) who represent charitable organizations act as agents for the charitable sector. Their role in the shaping of regulation should not be overlooked.
378. RICHARD F. FENNO, JR., CONGRESSMEN IN COMMITTEES 1 (1973) (identifying three goals of legislators: reelection, prestige, and good policy making); HAYES, supra note 32, at 93 (citing David Mayhew and Morris Fiorina that “the primary goal of most congressmen is to achieve reelection”); Shaviro supra note 40, at 83 (noting that, although not the only goal, reelection is a prerequisite for everything else).
379. Pork-barrel spending seeks to maximize the economic welfare of the legislator’s constituents to insure that the legislator can count on the loyalty (i.e., votes) of a particular geographical group.
380. For a discussion of logrolling see MUELLER, supra note 10, at 82-87.
381. For a discussion of constituent casework see Shaviro, supra note 40, at 90.
382. Shaviro provides a very useful example of the inefficiency of pork-barrel spending in the case of hypothetical military bases. Id. at 38.
383. Logrolling is a necessary strategy in a majority rule system because it secures votes for minority backed legislation, particularly where there are concentrated benefits and diffuse cost. Critics point out that logrolling can lead to excessive government spending. MUELLER, supra note 10, at 83.
tape" on behalf of their hopefully grateful constituents. However, the vote-maximizing politician does not rely on voter loyalty because another branch of public choice theory has shown that voting is a tricky business. Instead, the vote-maximizing politician seeks to exchange favorable regulation for more tangible signs of support from interest groups, namely campaign contributions.

To fill their campaign chests, legislators broker "rent-seeking" legislation at the request of interest groups and the ultimate expense of society. Rent-seeking legislation can be socially wasteful from a cost-benefit standpoint where the value of the wealth transfer from the legislation is.
public, the cost, is greater than the benefit transferred to the special interest.\(^{391}\) Interest groups are said to seek rents when they lobby for the government regulation needed to secure the rent.\(^{392}\) In addition to producing social waste, the activity of rent-seeking involves substantial transaction costs.\(^{393}\) James Buchanan categorizes potentially wasteful rent-seeking expenditures as: (i) lobbying costs of the rent-seekers; (ii) the response of the government officials to the lobbying efforts; and (iii) third party effects of the regulation.\(^{394}\)

Legislation. Farber and Frickey provide the very useful example of government mandated access for the disabled. The special interest legislation may be rent-seeking in that “it may well cost society more to give the access than the handicapped would be willing to pay to obtain it.” Id. Farber and Frickey conclude with regard to the cost factor that “this is probably true; otherwise the market would already offer access to the handicapped.” Id. Notwithstanding the “rent-seeking” nature of the legislation, access for the disabled is considered socially desirable.

391. For a concise description of “rent-seeking” see Eskridge, supra note 24, at 294-95. Frickey and Farber define “rent-seeking” as “legislation [that] is not justified on a cost-benefit basis; it costs the public more than it benefits the special interest, so society as a whole is worse off.” FRICKEY & FARBER, supra note 34, at 34.

392. Mueller notes that rent-seeking in the case of regulation can occur “at the time the initial legislation establishing or altering a regulatory process is voted upon.” MUELLER, supra note 10, at 238.

393. Mueller notes that rent-seeking expenditures can fully dissipate the rents secured. Id. at 235.

394. Id. at 230-31 (quoting James Buchanan). To put this in context, consider the time line of the case studies presented in Part III. The charitable sector mobilizes to oppose proposed rulemaking or other agency action. Later, its request to forestall negative regulation expands to a request for affirmatively favorable regulation. The immediate costs to the rent-seeking charities are the fees for the services of professional lobbyists and lawyers. In addition, the charitable organizations spend considerable time learning the law, submitting statements, appearing at hearings, and otherwise coordinating the lobbying activities. Time spent in this pursuit is time not spent in furtherance of the organizations’ charitable purposes, thereby harming the ultimate charitable beneficiaries.

The response of government officials to the lobbying efforts involves substantial cost to both the legislative and the executive branches. In addition, officials from the IRS and Department of the Treasury and legislators have to deal with the influx of letters and inquiries from the charitable community and its supporters. Members of Congress lobby the IRS and Treasury, and draft and debate legislation designed to respond to the demands of the charitable community and threaten the tax authorities. Senior Treasury officials respond to charities as well as to influential members of Congress. Finally, the IRS convenes at least one, and in another case two, public hearings.

The effect of the requested action on third parties is more difficult to evaluate. An obvious cost is the expense incurred by the losing side. MUELLER, supra note 10, at 237. Consistent with the theory of the demand for and supply of legislation, however, the interests bearing the costs of the rent are not organized and do not object. In the case of the corporate sponsorship rules described in Part III, with the exception of the Center for Commercialism, there was no organized effort supporting the proposed agency action. This observation contradicts Zelinsky’s assertion that expertise informed by neutral
Arguably, the case studies presented in Part III offer an example of rent-seeking behavior. Although a rent-seeking analysis provides interesting insight into the price or costs of favorable regulation, in the case of charitable organizations, it is not the cost that interests us, but rather the process of exchange.\textsuperscript{395} Regardless of the price, the question remains as to how charitable organizations participate in the public choice political marketplace for legislation.

3. APPLICATION OF THE PUBLIC CHOICE MODEL

In addition to the staples of votes and contributions, it is possible to augment the public choice model to account for a wide variety of incentives other than direct payments of votes or contributions.\textsuperscript{396} Very quickly, however, the expansion of the model can lead to a slippery slope where virtually any act by a legislator is considered self-interested because the legislator chose it. Thus, even acting in the public interest can be motivated by self-interest, if the legislator has developed a "taste" for the

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\begin{enumerate}
\item[395.] Zelinsky, supra note 30, at 1179 ("In the processes of tax-writing and tax administration, each of these interests is more likely to find itself contending with competing groups."). The opposite holds true for charities because the commonality rests in the tax treatment. Beyond that, the community breaks down into smaller industry specific groups. Given the rate of letters pro and con for the corporate sponsorship regulations and the information presented at the hearings, the regulators and the tax writers did not get a balanced picture of the proposed regulations.

\item[396.] But see McCormick & Tollison, supra note 24, at 23.
\end{enumerate}
\end{footnotesize}
This section considers the range of advantages that charitable organizations can offer the self-interested legislator. It concludes that even an aggressive expansion of the medium of exchange produces a relatively weak explanation for the quick dispatch with which legislators respond to charitable organizations. It does produce, however, a picture of the resources and limitations of the charitable community. In Part V, charitable organizations are recast as not simply another interest group, but as an integral part of a fundamental reordering of social priorities. Part V presents a much more persuasive argument as to why legislators respond to charitable organizations. It also discusses how the charitable community views the reallocation.

a. Votes and endorsements

The prohibition against participation in political campaigns means that charitable organizations cannot endorse or oppose a candidate for public office. The penalty for violating this restriction is loss of tax-exempt status and a substantial excise tax on any prohibited expenditures. As explained in Part II, even nonpartisan voter education can be interpreted as a prohibited endorsement with a severe sanction. Charitable organizations can publish and distribute voting records, but they cannot express an opinion on the desirability of electing a politician with such a record. This means that at best, and still not without risk, charitable organizations can offer a subtle endorsement of candidates. Although this is a far cry from an endorsement by the AFL-CIO or AARP, such symbolic endorsement of a large membership organization might translate into considerable voter loyalty. Perhaps the

397. For a discussion of the role of ideology in public choice theory see Lee, supra note 42, at 193 (explaining how legislators develop a "taste" for certain ideological positions).
398. For a full discussion of the prohibition on political activities see supra text accompanying notes 105-09.
399. See supra note 109.
400. Very few charitable organizations lose their tax exemption on this basis. The new regulations suggest for the first time that there may be a de minimis exception to the revocation requirement. The corresponding severity of the sanction for private inurement led to the push for intermediate sanctions. See supra note 109.
401. See supra text accompanying notes 105-09.
402. In a roundabout way, the claims that Governor Whitman's campaign staff paid urban African-American ministers to suppress voter turnout illustrate that churches do participate in elections despite the absolute prohibition against such behavior. See Jerry Gray, U.S. Investigating Claims of Payoffs by Whitman Staff, N.Y. TIMES, Nov. 13, 1993, § 1, at 1. The claims justifiably incited much controversy. No one complained, however, that the churches should not be involved in politics whether for or against a particular candidate.
vote-maximizing politician simply looks through a charitable organization to see its members or other constituents.\textsuperscript{403}

The decision to support a particular charity is thus similar to the calculus involved in pork-barrel legislation. The legislator who supports a given charity expects in return the voter loyalty of the constituents of the charity. The analogy, however, is not perfect. Unlike the beneficiaries of pork-barrel projects, the constituency of a given charity does not always break down along state lines or those of congressional districts. Accordingly, support for particular charities provides a relatively inefficient way of identifying constituents.

\textit{b. Campaign contributions and other revenue opportunities}

Although campaign finances are subject to ever-increasing regulation,\textsuperscript{404} they remain the much discussed medium of exchange in public choice scholarship.\textsuperscript{405} Charitable organizations are barred by the very terms of their exemption from making contributions because of the absolute prohibition against any activity designed to support (or oppose) a candidate for public office.\textsuperscript{406} As explained above, the penalty is loss of exemption and substantial excise taxes.\textsuperscript{407}

It is always possible that charitable organizations routinely violate the prohibition or resort to outright bribes in order to get the attention of legislators.\textsuperscript{408} Without some hard evidence, however, it is incredulous to conclude that the interest group influence observed in the case studies is the result of widespread graft and corruption on the part of Congress and the charitable community. The same is true to a lesser extent of the possibility that charitable organizations directly engage in widespread

\begin{footnotes}
\item 403. Many charitable organizations are not organized on a membership basis. Accordingly, the politicians would look to the donors and other supporters of the organization.
\item 405. For example, Zelinsky measures PAC contributions to certain congressional committee members as evidence of capture. One reason relatively small groups with intense demand more easily overcome free-rider tendency is that the size of industry interest groups is generally not large enough to deliver a significant voter block. See MUELLER, supra note 10, at 308 (noting that it is easier to form an interest group when the number of potential members is small than when the number is large).
\item 406. See supra text accompanying notes 105-09.
\item 407. See supra note 108.
\item 408. Bribes are payments made with the intent to secure favorable legislative treatment for the payor. See MUELLER, supra note 10, at 246 (citing SUSAN ROSE-ACKERMAN, CORRUPTION (1978)).
\end{footnotes}
violation of the prohibition against intervention in political campaigns. 409

Until the recent reform in the rules governing congressional speaking fees, 410 honoraria or speakers' fees were a significant source of revenue. Certain members of Congress made considerable amounts in speakers' fees each year. 411 In an interesting twist, the new rules require members of Congress to donate their fees to charity. This makes charities the potential recipients of fees rather than the sources. Even before the new rules, charitable organizations that agreed to pay honoraria had to be concerned about whether they were violating the prohibition on political activities.

c. Future economic opportunities and present commitments

It is possible that legislators (and regulators) view the charitable sector as a setting for future job opportunities. Top managers from the charitable sector are regularly recruited to the public sector and vice versa. 412 It is not clear whether this tendency is strong enough that legislators (and regulators) perceive friendly relations with the charitable community as a form of retirement or post-government insurance. 413 In any event, future job opportunities should be a larger factor in the case of private industry interest groups where post-government employment can offer highly remunerative positions. 414

A more immediate explanation is that many legislators are involved in varying degrees, and varying capacities, with charitable organizations.

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409. See supra note 109.
412. Kristen A. Goss & Elizabeth Greene, Clinton Expected to Tap Non-Profits for Talent, CHRON. PHILANTHROPY, Nov. 17, 1992, at 10 (reporting charity officials considered for top jobs in the Clinton administration); Kristen A. Goss & Elizabeth Greene, Next Stop for Some Former Bush Aides: The Non-Profit World, CHRON. PHILANTHROPY, Jan. 26, 1993, at 12 (noting Bush administration officials moving into the nonprofit world).
413. In the case of industry, this presumption helps explain regulatory capture. See Stigler, supra note 24, at 219-21.
414. See Top Charity Executives Earn Six Figures, N.Y. TIMES, Apr. 5, 1993, at A15. For a more recent review of the range of salaries at charitable organizations, see Susan Gray & Elizabeth Greene, Big Salaries Just Keep Going Up, CHRON. PHILANTHROPY, Sept. 7, 1995, at 1 (reporting that a "survey of 184 organizations has found that 154 of them paid at least one top executive more than $100,000 a year . . . [and] 83 gave at least one official more than President Clinton's $200,000 salary").
Legislators serve on the governing boards of charitable organizations, raise funds on behalf of charities, and, in many cases, start their own charitable organizations. This exposure, and perhaps ensuing sense of loyalty, might predispose these members of Congress to act in a way identified as favorable by the charitable community.

d. Public relations

Daniel Shaviro likens certain politicians to mass-marketed commercial products. Continuing in this vein, it is possible that politicians view support of the charitable sector as an opportunity to generate favorable media coverage. A politician’s marketing decision to curry favor with the charitable community is equivalent to the marketing strategy employed by private firms when they associate with charities in order to exploit the charitable goodwill, known in the marketing industry as the “halo effect.” Legislatators support the charitable community in order to generate the favorable voter perception that they are acting in the public interest.

The policy disputes concerning the Section 861 Proposed Regulations and corporate sponsorship rules that are discussed in Part III received very little coverage in the general press. Thus, a legislator who

415. As of April 1995, Senators sat on the boards of over 60 charities and House members on the boards of almost 250. Stephen G. Greene et al., Charities’ Congressional Connection, CHRON. PHILANTHROPY, Apr. 6, 1995, at 1, 30.

416. Fundraising requests from a member of Congress might carry more weight with a corporate donor and present an opportunity for the donor to make a contribution that is not a political campaign contribution. Stephen G. Greene & Grant Williams, When Charity Begins in the House and Senate, CHRON. PHILANTHROPY, Oct. 18, 1994, at 1, 28-31 (discussing the appearance of impropriety and the opportunity for “influence peddling”). In addition, the congressional involvement can politicize the activities of the donee charity. Grant Williams, Did Group With Ties to House Leader Cross the Line on Political Activity?, CHRON. PHILANTHROPY, Apr. 6, 1995, at 31 (describing Rep. Armey’s close ties with the Leadership Institute, a conservative policy organization, and his fundraising letter that urged donors to “fight to stop Bill and Hillary Clinton’s campaign to radicalize America”).

417. Stephen G. Greene & Grant Williams, supra note 416, at 28 (“[D]ozens of members of Congress have started their own foundations and charities.”).

418. Shaviro, supra note 40, at 92 (describing political entrepreneurs as mass-marketed commercial products).


420. This assumes, of course, that the general public perceives support for the efforts of charitable organizations as serving the public interest. A legislator who simulates the public good is similar to interest groups who cloak their requests “in public-regarding terms.” Eskridge, supra note 24, at 292.

421. It is instructive to compare the yields of the identical search in two different data bases. The search term “corporate sponsorship and charity!” produced only two
advocated a pro-charity position on either issue had no real opportunity to benefit from favorable press coverage. But contemporaneous press coverage is not essential because the legislator can later claim credit for the pro-charity stance when running for reelection. The lack of press coverage thus places the burden on the legislator to assert affirmatively his or her support. The legislator is not the passive object of press coverage, but instead takes strategic positions and builds a record to later boast about at campaign time.

\hspace{0.3in}e. Taste for symbolic legislation

The expansion of the public choice models leads to this last category. Some legislators might support the requests of the charitable community because they have developed a taste for public interest legislation\textsuperscript{422} or a desire to be known as policy makers\textsuperscript{423} and they believe that supporting pro-charity legislation will further these goals. The taste for symbolic legislation is akin to consumption. Politicians support symbolic legislation not to maximize their chances of reelection, but to maximize their self-interest, as more broadly defined.

To say that legislators support pro-charity legislation because they have a desire to support legislation that is perceived as furthering the public interest or constituting good policy overlooks an important step in the analysis, namely the initial determination that pro-charity legislation does further the public interest or constitute good policy. The case studies do not reveal any considered determination that the proposed legislation was indeed in the public interest. If the case studies point to a taste for anything, it appears to be a rather uncritical taste for acting in accordance with the judgment of the charitable community. The basic assumptions that shape public perceptions of the charitable community


\textsuperscript{422} This sort of reasoning can lead to the inevitable demise of the public choice model because even the most extreme other-regarding behavior can be justified in terms of taste. See Lee, supra note 42 (describing the role of ideology).

\textsuperscript{423} Shaviro, supra note 40, at 86 (describing the desire of certain legislators to earn reputations as good policy makers).
remain unquestioned. No one asks whether charities: (i) perform social services more efficiently that the federal government; (ii) "lessen the burdens of government," by providing goods the government would have otherwise supplied; and (iii) require government subsidies to encourage charitable activities and contributions. The following section discusses these assumptions and their connection to the public interest.

B. The Public Interest Theory of Legislation

The public interest view of government holds that individuals enact laws and promulgate regulations to further the public interest. 424 Indeed, government intervention is needed to correct for the undersupply of certain public goods. 425 A political actor is motivated by the desire to do good, rather than to promote the actor’s self-interest. 426

Public choice theory emerged in response to this traditional market failure/public interest view of government. 427 In 1979, Gordon Tullock surmised that "the traditional view of government has always been that it sought something called the 'public interest.'" 428 He further predicted that "with public choice, all of this has changed." 429 Despite the fanfare, the hegemony of theories of self-interest was short-lived and quickly gave rise to critiques in economic, 430 political science, 431 and

424. For a thorough discussion of traditional public interest theory see Shaviro, supra note 40, at 31-64.
425. From a public choice standpoint, politics is a marketplace for public goods, plagued by free-rider concerns and rent-seeking special interest groups.
426. Shaviro, supra note 40, at 89 (noting the desire of many members of Congress to be "influential policy-maker[s]").
428. Id. at 12 (citing Gordon Tullock, Public Choice in Practice, in COLLECTIVE DECISION-MAKING: APPLICATIONS FROM PUBLIC CHOICE THEORY 31, 33 (Clifford S. Russell ed., 1979)).
429. Id.
legal scholarship.\textsuperscript{432} In general, these responses have been either empirical or prescriptive. Empirical studies introduce the notion of mixed motives and offer evidence that legislators do consider the public good.\textsuperscript{433} Prescriptive theories, such as the recent revival in republicanism,\textsuperscript{434} stress the need for a political actor, whether voter, legislator or bureaucrat, to subordinate self-interest in favor of the public good.\textsuperscript{435}

1. PUBLIC INTEREST AND PRO-CHARITY LEGISLATION

A political actor motivated by the public interest supports the pro-charity bills introduced at the request of the charitable community on the grounds that they further the public interest. As explained above, what remains elusive is the initial determination that the proposed legislation serves the public interest (or what constitutes the public interest). Even if charitable activities were synonymous with public interest, it does not follow that granting every request by the charitable community for legislation or regulation furthers the public interest. Some requested legislation could be antithetical to the public interest, yet desired by charities. For example, charities could seek to repeal the requirement that charitable organizations make available for public inspection their Annual Information Returns, Forms 990, and their Applications for Recognition of Exemption, Forms 1023.\textsuperscript{436} Although charities might welcome such

\begin{itemize}
\item \textsuperscript{432} For a direct critique of public choice see Kelman, \textit{supra} note 39. The new republicanism offers a prescriptive model of political life.
\item \textsuperscript{433} For example, Paul J. Quirk has studied the deregulation of certain industries in the mid-1970s to the early 1980s and found evidence that Congress acted to further the public interest despite considerable interest group pressure to maintain the regulation. Paul J. Quirk, \textit{Deregulation and the Politics of Ideas in Congress, in BEYOND SELF-INTEREST} 183, 184 (Jane A. Mansbridge ed., 1990).
\item \textsuperscript{434} The revival of the republican ideal of civic virtue is a prescriptive movement asserting civic republicanism as a universal good. For articles dealing with the new republicanism and its critical responses see generally \textit{Symposium: The Republican Civic Tradition: Beyond the Republican Revival}, 97 \textit{YALE L.J.} 1539 (1988). For a discussion of the position of civic republicanism within the larger communitarian movement see Stephen A. Gardbaum, \textit{Law, Politics, and Claims of Community}, 90 \textit{MICH. L. REV.} 685 (1992).
\item \textsuperscript{435} Hayes views the suggestion that legislators subordinate their private interest as unrealistic. \textit{Hayes, supra} note 32, at 155. Even recognizing that members of Congress are not solely self-interested, he notes that reelection is a "prerequisite for all the other [goals]." \textit{Id.} at 156. Thus, politicians will not risk totally alienating their constituency. Hayes suggests that "changes in the behavior of the politicians will follow changes in the political attitudes of the electorate." \textit{Id.}

\item \textsuperscript{436} Charitable organizations that are not private foundations and that have gross receipts in excess of $25,000 must file an Annual Information Return, Form 990. I.R.C.
\end{itemize}
a change, it would greatly increase the cost of monitoring the activities of charitable organizations.\footnote{437}

The case studies in Part III show that there was actually very little deliberation as to the merits of the proposed rulemaking or legislation.\footnote{438} The testimony offered at the hearings was unanimously in favor of the action (or inaction) requested by the charitable organizations.\footnote{439} The public debate in Congress was limited to a recitation of the good that charity does for the country, with no discussion of larger issues of tax policy.\footnote{440} This lack of debate is one of the effects of the reallocation. It has given rise to a strong presumption that charities invariably serve the public interest and has foreclosed any case by case discussion of the desirability of specific tax subsidies. Thus, the public interested legislator supports the corporate sponsorship measures because the charitable community says that such measures are necessary, not because the legislator has made any specific determination that the bill serves the public interest.

2. THE UNEXAMINED ASSUMPTIONS

A thorough examination of the assumptions underlying the public perception of the charitable sector is well beyond the scope of this Article. However, this Article can begin to break down the assumptions to provide a blueprint for further research. This section explores four strongly-held beliefs concerning private charitable activities: (i) charitable organizations perform social services more efficiently than the federal government; (ii) charitable organizations "lessen the burdens of government," by providing goods the government would have otherwise supplied; (iii) tax incentives are necessary to encourage charitable activities; and (iv) tax incentives are the most cost-effective way to encourage such activities.

\footnote{437} For example, The Philadelphia Inquirer ran a series of articles in the form of an exposee about the charitable community. The series contained a considerable amount of information gleaned from reviewing these forms. The series was later compiled and published in book form. See generally GILBERT M. GAUL & NEILL A. BOROWSKI, FREE RIDE: THE TAX-EXEMPT ECONOMY (1993).

\footnote{438} See supra part III.

\footnote{439} See supra text accompanying notes 285-86.

\footnote{440} See supra text accompanying note 237.
These underlying assumptions must be addressed critically. The reallocation represents a massive shift of responsibility for desired social programs from the public sector to the charitable sector.441 In addition, the federal government devotes significant resources to tax subsidies for charitable activities.442 Society should not sanction such a shift of responsibility and resources without having a better understanding of the charitable sector.

a. **Charities are more efficient than government**

There is a pervasive belief on the part of the general public and elected representatives that charities are more efficient than government with regard to the delivery of specific social programs. The decision on the part of the government to leave the delivery of a needed service to the charitable sector involves a form of institutional choice between a government delivered social program and a program delivered by private charity.443 As currently practiced, this form of institutional choice is based on incomplete information. In order to make an informed choice among alternative institutions, it is necessary to identify the relevant institutions and the measure by which to choose among them.444 The reallocation only considers the relative merits of the public sector and the charitable sector. It does not take into account any of the shortcomings of the charitable community, and it overemphasizes the importance of efficiency or cost containment to the possible detriment of considerations of equity.445

The assertion that private charity is more efficient than government ignores the possibility that the private sector also could deliver certain social programs, particularly those involving a fee-based provision of a service, such as hospitals, nursing homes, and schools.446 Thus, the question does not consider a sufficiently broad range of alternative institutions. The little empirical research there is concerning the performance of the charitable sector typically compares it with the private

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441. **See infra text accompanying notes 485-503.**
442. **See infra note 472 (describing the magnitude of the tax expenditure budget).**
444. **See generally KOMESAR, supra note 443.**
445. **See Rubin, supra note 443, at 1426 (discussing a measure that balances efficiency with considerations of “social justice”).**
446. These are the so-called “commercial nonprofits.” **See supra text accompanying notes 156, 167-68.**
sector and not public sector performance. One explanation is that economic models of the charitable community endeavor to explain why entrepreneurs choose the charitable form for certain activities over the for-profit form. The belief is that the rational wealth-maximizing entrepreneur would not choose the nondistribution constraint of the charitable form without some compelling reason. That reason is usually expressed as consumer demand for the nondistribution constraint arising in the wake of contract failure.

When comparing the charitable sector to the public sector, one could make a compelling case that both the charitable sector and the public sector present opportunities for waste and inertia due to the nondistribution constraint and the corresponding lack of incentive to maximize profits through innovation and cost containment. It is easy to see how the private sector, with its profit-maximizing outlook, would offer superior efficiency, but it is much more difficult to point to a compelling reason for why the charitable sector should prevail over government.

The choice of charitable organizations over government could simply be the result of the perceived shortcomings of government and a wholly uncritical portrait of the charitable sector. The reallocation is fueled by political exigencies and colored by the negative images of waste in government and the excesses of big government. Thus, government is synonymous with waste and inefficiency, whereas the charitable community is cloaked in the “halo” and benefits from the unexamined assumptions regarding its nexus with public interest.

Before a determination can be made as to relative efficiency of the two sectors, the criticisms of the charitable sector must be factored into the analysis. These would include charges of paternalism, amateurism, and over-specialization. Moreover, it is possible that the standard of efficiency is not a sufficient measure to use when evaluating the

447. See, e.g., Hansmann, The Rationale for Exempting Nonprofit Organizations, supra note 90, at 70.
448. See supra text accompanying notes 142-62 (describing the contract failure theory).
449. It is possible that those who work in the charitable sector are self-selected and exhibit superior motivation along ideological lines.
450. See infra text accompanying notes 488-90.
451. See supra text accompanying note 59 (discussing the “halo effect”).
appropriate delivery system for a needed social service, and it should also be balanced against considerations of equity or social justice.453

b. Charities lessen the burdens of government

As explained in Part II, the charitable community and its supporters claim that charities deserve favorable tax treatment because they “lessen the burdens of government” and further pluralism.454 Doubtless, the activities of some charities relieve the government of some of its burden, but every activity engaged in by private charity does not correspond to a government savings of resources that it otherwise would have committed to the activity. “Lessening the burdens” of government is just one of many categories under which an organization can qualify as a charitable organization under the Internal Revenue Code.455 The vast majority of charitable organizations do not need to make any showing that they “lessen the burdens of government” in order to secure tax-exempt status.

The addition of a requirement that an organization must lessen the burdens of government would drastically reduce the number of qualifying charitable organizations. This is because charitable organizations engage in many activities that government cannot undertake and perhaps an even greater number of activities that government would not undertake.456 For example, the majority of charitable organizations are of a religious nature and many of them are actual churches. Many charitable organizations are organized to further very specific and perhaps controversial goals that are not widely shared. These activities could not win sufficient support by government to warrant government action.457 In addition, the particularized and localized natures of many charities make it difficult to see how they lessen the burdens of the federal government.

The most that probably can be said is that the activities of charities, to the extent they produce public goods, supplement the activities of the federal government, but do not in any meaningful way directly relieve the government of its self-identified burden. This is consistent with the public goods explanation for charitable formation where private charitable organizations are the result of intense demand for public goods on the part

453. Rubin, supra note 443, at 1426 (describing a measure of efficiency and social justice).
454. See supra text accompanying notes 121-141.
455. See supra text accompanying notes 132-134.
456. See supra text accompanying notes 135-136.
457. Interest group capture is one example of where intense demand on the part of relatively few individuals can result in government action.
of a relatively small number of individuals.\textsuperscript{458} Thus, charities provide public goods that would not otherwise be provided by either the market or the government, and they correct for market or government failure. These activities may produce a societal benefit, but they do not translate into a direct savings.

When government failure is left to private charity to correct, the result is imperfect. Not all groups with intense demand can successfully overcome free-rider obstacles, whether it be due to lack of resources, the high cost of information necessary to identify other similarly interested individuals, or access to the professional services necessary for organizational start-up.\textsuperscript{459} The structure of the tax expenditure for charitable contributions favors contributions from high income taxpayers.\textsuperscript{460} All these factors combine to make private charitable activity vulnerable to claims of elitism\textsuperscript{461} and paternalism.\textsuperscript{462} Even though the beneficiaries of many charitable activities are low income individuals, such beneficiaries rarely hold policy positions within the organizations. This means that the charitable agenda is set by those who contribute to charitable organizations not those who receive their largesse.\textsuperscript{463} Thus, it may be an overstatement to say that private charitable activity corrects for government failure. Perhaps it merely replaces government failure with “charitable failure,” or what Lester Salamon refers to as “philanthropic insufficiency.”\textsuperscript{464}

c. Tax incentives are necessary to support charitable activities

As explained in Part II, charitable organizations benefit from two tax subsidies: the exemption from income tax on income related to the organization’s exempt purpose and the tax-deductibility of

\textsuperscript{458} See supra text accompanying notes 142-62 (discussing the market or government failure theory).

\textsuperscript{459} See Salamon, supra note 452, at 111 (discussing the problem of “philanthropic insufficiency”).

\textsuperscript{460} See supra text accompanying notes 115-17 (discussing the after-tax effect of the income tax charitable contribution deduction).

\textsuperscript{461} See generally TERESA ODENDAHL, CHARITY BEGINS AT HOME: GENEROSITY AND SELF-INTEREST AMONG THE PHILANTHROPIC ELITE (1990).

\textsuperscript{462} See Salamon, supra note 452, at 111-13 (discussing the shortcomings of private charitable activity).

\textsuperscript{463} Id. at 112 (explaining that charitable activity “vests most of the influence over the definition of community needs in the hands of those in command of the greatest resources”).

\textsuperscript{464} Id. at 111.
Charities contend that they deserve such subsidies because they lessen the burdens of government and further pluralism. Economic justifications of the subsidies are that tax exemption is necessary to compensate for the lack of equity capital and tax deductibility is necessary to reduce the cost of charitable giving and thereby help overcome free-rider impulses.

The question of whether charitable organizations lessen the burdens of government is addressed above, and that rationale for favorable tax treatment seems rather weak. There remains, however, much to be said about the economic explanations for the tax treatment of charitable activities. First, the impact of the tax exemption is negligible for activities that do not produce taxable income. For such organizations, the package of benefits that come with tax exemption are more valuable than the exemption itself, and the nondistribution constraint is redundant because there is no anticipated profit. Such organizations do not "use" the exemption and, therefore, it does not produce any cost to the federal fisc. By the same token, however, the exemption does not compensate these organizations for the absence of investment capital.

The charitable contribution deduction reduces the cost of giving for certain individuals and corporations, resulting in an annual tax expenditure budget for charitable contributions of $26.15 billion. The deduction has no impact on the millions of individuals who give their money and their time to charitable organizations without receiving any tax

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465. See supra text accompanying notes 67-118 (describing the requirements for the dual subsidies).
466. See supra text accompanying notes 121-41 (describing the argument that charities further pluralism).
467. See supra text accompanying notes 144-48 (describing the rationale for the exemption from income tax for charitable organizations).
468. See supra text accompanying notes 157-62 (describing the rationale for the charitable contribution deduction).
469. In addition, the exemption is not considered a tax expenditure under the tax expenditure budget.
470. See supra notes 55, 67 (describing the various benefits attached to charitable status).
471. See supra note 115-17 (describing the after-tax cost of charitable contributions).
472. This is the fiscal 1996 estimate by the Department of the Treasury. It represents $24.145 billion in lost revenue on account of the charitable income tax deduction and $2.005 billion in lost revenue on account of the estate and gift tax charitable deductions. James J. Fishman & Stephen Schwarz, Nonprofit Organizations: Cases and Materials 843 (1995) (citing the Tax Expenditures Chapter from the President's Fiscal 1996 Budget).
benefit.\textsuperscript{473} A reasonable conclusion might be that the charitable
contribution deduction is not necessary to encourage contributions to
charity. This is the position taken by many of the recent flat tax
proposals which would eliminate the deduction entirely.\textsuperscript{474}

In the alternative, if it is desirable to continue federal subsidization
of charitable giving, then there could be an attempt to have the subsidy
reflect the giving patterns of all taxpayers or it could favor contributions
to certain types of charitable activities.\textsuperscript{475} Further, there may be ways
to structure the tax subsidy to avoid the current “upside down” effect of
the present deduction.\textsuperscript{476} Alternatives could include a credit for
contributions to certain organizations or some form of direct federal
matching grant based on charitable support.

d. Tax incentives are a cost efficient way of encouraging charitable
activity

This section asks what society gets in return for the cost of the dual
tax subsidies of exemption and the deductibility of contributions.\textsuperscript{477} It
is possible to measure the cost of the tax subsidies in terms of foregone
federal revenue. The difficulty arises in trying to measure the potential
 savings and benefits received on account of these subsidies.\textsuperscript{478} As
illustrated above, it is not accurate to state, across the board, that
charitable organizations lessen the burdens of government.\textsuperscript{479} Thus, a
dollar of benefit does not necessarily equal a dollar of savings.

\textsuperscript{473} Extending the charitable deduction to nonitemizers is a priority for
TAX NOTES TODAY 91-84, May 10, 1995} (reporting that 81 million taxpayers are
nonitemizers, and the average contributed by nonitemizers is $509).

\textsuperscript{474} The charitable contribution deduction is eliminated in the following “flat tax”
proposals: the Armey-Shelby flat tax proposal sponsored by Rep. Dick Armey and Senator
Richard C. Shelby, the Gephardt 10% Tax Plan proposed by Rep. Richard Gephardt, the
National Sales Tax Plan offered by Senator Richard Lugar, and the National Sales Tax

\textsuperscript{475} For a discussion of some of these more narrowly-drawn legislative proposal
see supra note 177.

\textsuperscript{476} See supra note 347 (discussing the “upside down” effect of tax expenditures).

\textsuperscript{477} There are state and local tax subsidies in addition to federal tax subsidies.
For a discussion of additional nontax favorable treatment of charitable organizations see
supra notes 55, 67.

\textsuperscript{478} This is evident from recent attempts to correlate the cost of the exemption
for charitable hospitals with the level of charitable care they provide. \textit{GAO Recommends
Linking Hospital’s Tax Exemption to Charitable Care}, 90 \textit{TAX NOTES TODAY} 137-3, June
29, 1990. In addition, Charles Clotfelter has recently edited a volume designed to
measure the redistributational effects of private charitable activity. \textit{See supra} note 319.

\textsuperscript{479} See supra text accompanying notes 454-64.
Moreover, much of the claimed benefit is intangible, such as furthering pluralism and diversity and, therefore, exceedingly difficult to value in monetary terms.

Much of the benefit also falls more directly to the state or local governing units so even if one could measure the benefit, it is unclear what quantum of the benefit ultimately inures to the federal government. An example of this is private elementary and secondary schools. It is possible to quantify the additional cost to the local public school system of educating all the dependents of local residents who are enrolled in private schools. This would represent the amount saved, but it is a savings realized principally on the local level. 480 There is an arguable benefit realized on the federal level, but it is not easily measured in monetary terms. The result of the analysis is a local savings, a possible benefit, and a definite cost equal to foregone federal revenue. In other cases, where the charitable activity does not directly relieve the government’s burden, there might be no clear savings, but a measurable benefit.

State and local authorities have experimented with a wide variety of efforts to curtail the scope of charitable exemptions and other benefits. One example is the local property tax exemption. As a result of the exemption, charitable organizations are entitled to receive certain city services, such as police and fire protection, without payment. In some jurisdictions it is common for charitable organizations to make payments “in lieu of taxes.” 481 The payment in lieu of taxes insures that charities pay for what they receive, but it does not take into account the benefit they provide. The measurement of the benefit provided by the charitable community is an essential element to any analysis of whether tax incentives are a cost effective way of encouraging charitable activity.

V. THE REALLOCATION OF RESPONSIBILITY

When viewed in the context of the reallocation, the charitable community is not simply another interest group. The intersectoral shift in the responsibility for social programs makes the reasons legislators respond to charitable organizations much more compelling. The legislator is not responding to an interest group with narrowly defined goals, but rather is using charitable organizations as a creative way to respond to the pressures of fiscal restraint budgeting and the conservative emphasis on

480. This calculation can be complicated by geography where students do not attend private schools located in their home school districts.

481. This is particularly true in the case of large organizations that provide services on a fee basis, such as hospitals and universities.
personal responsibility. This section suggests that the charitable community, as empowered by the reallocation, offers the legislator ideological appeal, advertising currency, and an opportunity to claim credit for policy making with little or no continuing responsibility for the outcome.

More specifically, a strong charitable community has something to offer both the self-interested and the public-spirited legislator. It offers the self-interested legislator a golden management opportunity and the potential to generate favorable public relations.\textsuperscript{482} The public-spirited legislator gets the chance to further various ideological goals, as well as the opportunity to claim credit with no responsibility.\textsuperscript{483} A final section notes that charities view durable tax subsidies as an implicit part of the bargain that is at the heart of the reallocation.\textsuperscript{484} If charities stoically accept greater responsibility, then in return they demand durable tax subsidies. It further suggests that this bargain for durable tax subsidies might arise at the point when an entrepreneur resolves the choice of entity question in favor of the charitable form, thereby further complicating any attempt to reform the existing contours of the tax treatment of charitable organizations.

\textit{A. Ideology: The Goals of Deficit Reduction and Increased Personal Responsibility}

The appeal of ideology to the public-interested legislator is obvious, but it also has something to offer the self-interested politician. It is possible that the politician has developed a taste for taking ideological stands\textsuperscript{485} or desires to develop a reputation for being a good policy maker.\textsuperscript{486} Finally, the truly calculating politician could simply simulate that he or she was acting in accordance with popular ideology to gain favorable public relations.\textsuperscript{487} The following describes the ideological appeal of the reallocation.

In the 1980s, the pressing need to curtail the rising federal deficit added a level of urgency to the conservative agenda to reduce federal spending, decrease the size of the federal government, and return

\begin{itemize}
\item[482.] \textit{See infra} text accompanying notes 510-19.
\item[483.] \textit{See infra} text accompanying notes 485-509 and 512-19.
\item[484.] \textit{See infra} text accompanying notes 520-40.
\item[485.] \textit{See supra} text accompanying notes 422-23 (discussing the development of a self-interested "taste" for ideological stands).
\item[486.] \textit{See} Shaviro, \textit{supra} note 40, at 86 (discussing the desire of some legislators to be known for their policy initiatives).
\item[487.] \textit{Id.} at 90-91 (discussing legislators who simulate acting in the public interest).
\end{itemize}
responsibility to state and local authorities. Support for private charity furthered these ends. A central feature of the argument for a smaller federal government is the popular picture of a runaway, uncontrollable, and wasteful federal bureaucracy. The theoretical underpinning of this image is found in William Niskanen's influential Bureaucracy and Representative Government. Niskanen theorized that since bureaucrats could not maximize profits, they seek to maximize the budgets of their bureaus in order to maximize their salaries. The result is a larger than optimal bureau output.

Niskanen explained that the runaway growth was facilitated by Congress' weak incentive to monitor the bureaucracy. The political response to this now-familiar scenario is shared by Republicans and Democrats alike. These shared goals include the desire to cut waste, reduce spending, and even eliminate certain programs and agencies. To this end, the Clinton administration announced that "reinventing government" would be one of its top priorities.

The conservative ideology of the Reagan and Bush administrations stressed a smaller federal government with renewed responsibility in the hands of state and local governments and, ultimately, the private sector. The charitable community was a natural place for the federal government to look for assistance because there was a considerable overlap of

488. The recent reinvention of the federal entitlement system provides a good example of this.

489. NISKANEN, supra note 326, at 38 (theorizing that bureaucrats seek to maximize their bureau's budget and explaining why legislators lack the incentive and the necessary information to control the bureaucrat). Niskanen has since revisited his original thesis and now asserts that bureaucrats seek to maximize their discretionary budgets. William A. Niskanen, A Reflection on Bureaucracy and Representative Government, in THE BUDGET-MAXIMIZING BUREAUCRAT: APPRAISALS AND EVIDENCE 13, 18 (Andre Blais & Stephane Dion eds., 1991). This refinement was the result of empirical studies that indicate that a bureaucrat's salary is not strongly related to the budget of the agency. Id. at 18. Niskanen's earlier work had assumed that this was the case.

490. Niskanen, supra note 489, at 18. Niskanen further conceptualized the relationship between bureaucrats and Congress as a bilateral monopoly where the demand side has insufficient information concerning the costs of the services and insufficient incentive to monitor the bureau in order to insure efficiency. Id.


492. An example of these shared goals is the recent attempt to dismantle the Commerce Department.

493. For a description of the efforts of the Clinton administration to create a government that "works better and costs less" see Knauer, supra note 138 (forthcoming 1997); see also Gwen Ifill, Gore Jumps Into the Job of Cutting U.S. Waste, N.Y. TIMES, Aug. 20, 1993, at A20.
services. By contrast, the for-profit sector was not equipped to provide the necessary services. It was able, however, to make contributions. The reallocation of responsibility for certain social initiatives and the preferred status of charitable organizations has led both the executive branch and the legislature to create separate private charitable organizations to perform certain government functions.

Early in his presidency, Ronald Reagan emphasized the desirability of voluntary efforts and private charity. This focus culminated during the Bush administration with the creation of the Points of Light Foundation. President Clinton designated twenty-six top senior officials to serve as "liaisons" to the charitable community, thereby illustrating the interdependence of the two sectors. Although Clinton continued support for the Points of Light Foundation, his emphasis on voluntarism focused on the Americorps national service program—a

494. ABRAMSON & SALAMON, supra note 1, at 25.

495. An early effort in the Reagan administration increased the ceiling limitation on the charitable contributions of corporate taxpayers from 5% of taxable income to 10%. See Knauer, supra note 138 (forthcoming 1997). The purpose was to encourage and increase corporate charitable giving.

496. For a description of these "government created charitable organizations" see id. (describing the institutional choice central to the formation of government created charitable organizations). For example, President Bush created the New American Schools Development Corporation (NASDC) to design educational policy to take the United States into the twenty-first century. Karen DeWitt, Bush Sets Up Foundation to Start Model Schools, N.Y. TIMES, July 9, 1991, at A13. The NASDC was headed by representatives of business and it was instructed to solicit its revenue from corporate philanthropy. Karen DeWitt, Private-Sector Grants Given for a New Breed of Schools, N.Y. TIMES, July 10, 1992, at A13.

497. ABRAMSON & SALAMON, supra note 1, at 24 (quoting a September 1981 speech where Reagan stated: "The truth is that we've let government take away many of the things we once considered were really ours to do voluntarily . . . ."). In 1981, Reagan appointed the Task Force on Private Sector Initiatives to study whether the private sector, principally charity, could make up for the reduction in federal funding. HALL, supra note 1, at 80. The Task Force failed to reach a conclusion, but the administration did propose the increase in the ceiling on the corporate charitable contribution deduction under I.R.C. § 170 from 5% of gross income to 10% of gross income. Id.

498. See supra note 204.

499. President Clinton appointed 25 senior officials to serve as "liaisons" to charities and foundations. This included one for each cabinet post and several federal agencies, including the Deputy Executive Secretary for Public Liaison at the Department of the Treasury. Kristin A. Goss & Jennifer Moore, Clinton Seeks Closer Ties with Non-Profits, CHRON. PHILANTHROPY, Apr. 19, 1994, at 28.

target of continued congressional opposition. Even though there remains a debate as to the means, there seems to be a general agreement that encouraging private charitable efforts should be part of federal social policy.

The Clinton administration has made it clear that the activities of the charitable sector are an integral part of the national policy regarding the provision of social services. In a speech before nonprofit leaders, Clinton remarked, "I cannot succeed as President unless you succeed, and unless you succeed in mobilizing millions of our countrymen and women for the important tasks that face us." Donna E. Shalala, the Secretary of Health and Human Services, was more blunt. Referring to the charitable community, she said, "We're in it together. Most of the President's priorities—kids, health care, welfare reform—are also what nonprofits are into. We don't have enough money at the federal level, so it's a partnership."

B. Advertising: The Public Empowerment of the Charitable Community

Advertising is closely related to ideology. In fact, without advertising, ideological stands have little value. Advertising can be considered the public aspect of ideology because it is the act of telling the general public about certain, presumably popular, stands the politician has taken. It is through advertising that a politician publicly claims credit for assuming certain policy positions. After all, what good is taking a popular or sympathetic position if no one knows about it? It also is possible to use advertising as a negative tool. This entails telling the public about certain, presumably unpopular, stands an opponent has taken. Legislators seek to avoid being the subject of such negative advertising.


503. Id. at 29.

504. See supra note 418.
Advertising has something to offer the self-interested and the public-spirited legislator. The self-interested legislator seeks to maximize his chances of reelection. Advertising is the legislator's opportunity to present his record to the voters. It is also the opportunity to reveal the "truth" about the legislator's opponent(s). The reelection-minded politician markets himself in such a way as to maximize voter appeal. Here, the politician borrows heavily from the lessons learned by the marketing and advertising industry. Strategic policy positions are packaged to have the right spin.

The public-interested legislator is presumably proud of the positions he has taken during his term. Advertising is the opportunity to inform voters as to the legislator's positions on a variety of issues, and perhaps warn the voters regarding the positions taken or espoused by the opponent. Thus, advertising serves the very important function of dispersing essential voter information.

Supporting the reallocation and other pro-charity legislation provides either legislator with considerable advertising currency. This is because of the widely-held beliefs that private charity is more efficient than government programs and morally superior to government handouts.505 A carefully drawn advertising campaign can successfully capitalize on the favorable public perception regarding both restraint budgeting and the role of private charity in furthering the public interest.

Advertising also has the effect of reinforcing these favorable views about charitable organizations. As politicians assert the importance of private charitable activities, they are transmitting these values to the voters. Eventually, the voters themselves demand them.506

The activities of charitable organizations also help spread the word that a given legislator is a friend to charity. Politicians do well when they are associated with supporting private charitable activities as a result of the "halo effect" that is reinforced through advertising.507 Thus, legislators can benefit from public associations with charitable organizations much the same way as consumer products benefit from cause-related marketing where the manufacturer devotes a portion of the purchase price to a stated charitable purpose.508 Eventually the product and the favorable associations of the charitable purpose become linked in the consumer's mind. The advertising currency afforded by the

505. A criticism of the Americorps program is that it pays individuals for work that should be done by volunteers. See supra note 501.
507. See supra note 59. During the 1996 presidential debate, Bob Dole continually referred to the charitable organization he created to assist disabled individuals.
508. For a description of cause-related marketing see Knauer, supra note 215, at 64.
reallocating includes not just the generally favorable perception of charity, but also the ideological appeal of a smaller and more efficient federal government and increased individual responsibility. 509

C. A Golden Management Opportunity: Delegation or “Policy-Without-Law”

In addition to ideological appeal and advertising currency, the reallocation presents legislators with a golden management opportunity. If we assume that legislators desire reelection,510 or, at a minimum, desire not to be pilloried, then legislators avoid potential blame or responsibility. The reallocation offers the legislator the ability to claim credit for encouraging private charitable efforts, but unlike delegation to an administrative agency, the legislator does not remain ultimately responsible for the actions of the charitable community. To the contrary, if voters perceive a failure in the charitable community, then it is a failure in themselves—the failure to produce the desired level of public goods.511 All government does is provide certain narrowly-tailored incentives to encourage charitable giving and charitable activity.

This behavior is consistent with the theory of legislative delegation.512 Political scientists predict that legislators delegate authority to an administrative agency when they are faced with hard choices513 or lack sufficient information.514 In the words of Theodore Lowi, delegating regulatory authority permits the legislator to make “policy without law.”515 In fact, the delegation later permits the legislator to engage in important constituent casework by offering to cut through all the red tape created by the exercise of the regulatory authority.516 The potential cost to the legislator, however, is relatively high. Niskanen’s model reveals the creation of a monopoly supplier that

509. For a description of the ideological appeal of the reallocation see supra text accompanying notes 485-503.
510. HAYES, supra note 32, at 93; see also Shaviro, supra note 40, at 82.
511. President Clinton actually said this in a speech before nonprofit leaders. See Goss & Moore, supra note 499, at 28.
512. From a prescriptive public choice standpoint, the delegation to administrative agencies with insufficient monitoring suggests that courts should not defer to regulation. FARBER & FRICKEY, supra note 34, at 78-87.
513. HAYES, supra note 32, at 97 (explaining Lowi’s policy-without-law). Hayes describes the incentive to delegate: “Ambiguous legislative mandates provide congressmen both with a mechanism for avoiding hard choices among contending groups in the short run and with a fruitful source of particularized benefits later on.” Id. at 94.
514. Id.
515. Id. at 140.
516. Id. at 97 (stating that casework is made possible by the scope of delegation).
Congress is unable and unwilling to monitor, and for which it retains ultimate responsibility.\textsuperscript{517}

The reallocation is superior to delegation because the legislator does not retain any responsibility for the ultimate success of the charitable sector. Any perceived failure is the responsibility of the community and not the government. The legislator is able to claim credit under both important policy goals of reducing government spending and encouraging volunteer efforts.\textsuperscript{518} This appeals to the self-interested and the public-interested legislator. There is no need to create a bureaucracy—a monopoly supplier for whom they are ultimately responsible. As explained below, the only cost is the maintenance of popular tax subsidies.\textsuperscript{519}

\textbf{D. The Reallocation as Bargain}

The constant refrain of the charitable community is that its resources are strained under its added responsibility for social services. The deficit reduction budget policies of the 1980s affected charitable organizations in two ways.\textsuperscript{520} First, the reduction of government spending programs in areas such as the arts and social services increased the burden on the services of charitable organizations.\textsuperscript{521} Second, the reduction in spending directly affected charitable organizations which provided needed services under government contracts.\textsuperscript{522} Thus, the budget policies decreased the receipts of charitable organizations at the same time they were being asked to handle a greater caseload.\textsuperscript{523}

\begin{footnotes}
\footnotetext{517}{Niskanen, supra note 326, at 45.}
\footnotetext{518}{This would include not just volunteer time, but also funds.}
\footnotetext{519}{This is true unless there is a perceived cost involved in reallocating the oversight responsibility to the private sector. This is difficult to articulate since the reallocation is now defined by public policy as a desired goal. The cost of the tax subsidies is often overlooked in the reallocation rhetoric.}
\footnotetext{520}{Abramson & Salamon, supra note 1, at 23. Of course, there may be many indirect effects of the restraint budgeting that would increase the strain on the services provided by charitable organizations. For example, cutbacks in social welfare, mental health, and job training programs might increase the number of homeless individuals.}
\footnotetext{521}{Id.}
\footnotetext{522}{Id. This is referred to as "nonprofit federalism." The federal government uses charitable organizations as third-party providers for certain services. Id. at 54.}
\footnotetext{523}{Although this second point seems obvious, it was not at the time of the proposed budget cuts. Abramson and Salamon's analysis of the 1987 budget proposed by President Reagan goes to great lengths to explain and make visible the extent to which the federal government would "contract out" the provision of various services. Id. at 56-66 (providing a historical overview of the development of the partnership between the federal government and the charitable community).}
\end{footnotes}
Fifteen years after the original budget cuts, the charitable community now has to face the new Republican revolution, the "Contract with America," and more cuts in social services.524 Recently, Independent Sector produced a statement addressed to members of Congress and signed by 116 charitable organizations.525 The statement explained that the charitable community could not handle the added burden even with the new proposed tax incentives.526 Many pro-charity tax cuts proposed by the conservative members of Congress are very narrowly-drawn to target specific types of charity.527

In the case studies in Part III, charities characterize the reallocation as a bargain. They have accepted the burden of increased responsibility in exchange for which they demand durable tax subsidies, something that is increasingly rare in an age of frequent tax reform.528 The charities argue that the federal government, specifically Congress, should not in good faith hamper the activities of the charitable sector by reducing existing tax benefits.529 The legislators respond to this reasoning because the existence of a willing charitable sector carries with it ideological appeal, voter goodwill, and opportunities to manage pressing social needs by reallocating the responsibility for them to private philanthropy.530 As is clear from the case studies, charities denounce any attempt to alter the existing tax treatment of charities as government hostility—attempts to undermine the government’s newly-created partner.531 The case studies also show how easily an argument against proposed negative regulation becomes a persuasive argument in favor of additional tax benefits.532

As discussed in Part IV, the argument on behalf of the charitable community is based on a series of largely unexamined assumptions: (i) charities provide social services more efficiently than the federal government; (ii) charities lessen the burdens of government; (iii) tax

524. Charities claim that even with tax breaks, the reforms will overwhelm their resources. Marina Dundjerski & John Murawski, Republicans’ Welfare Reform Could Be Charities’ Burden, CHRON. PHILANTHROPY, Nov. 29, 1994, at 6.
525. Non-Profit Groups Tell Congress They Cannot “Do It All”, CHRON. PHILANTHROPY, Feb. 23, 1995, at 47.
526. Id.
527. For a description of some of these proposals and the role of conservative think tanks in formulating policy towards charities see Vince Stehle, Conservative Centers Set Agenda on Charities, CHRON. PHILANTHROPY, Sept. 21, 1995, at 32.
528. For a discussion of durable tax subsidies see supra note 22.
529. See, e.g., supra note 222.
530. See supra text accompanying notes 485-503.
531. See, e.g., supra notes 282-83.
532. This is exactly what happened with the § 861 regulations. See supra note
incentives are necessary to encourage charitable activities; and (iv) tax incentives are a cost-effective way to encourage such activities. The charitable community paints with a very broad brush the economic and moral benefits associated with private charitable activities. It also reminds the politician that the reallocation of responsibility can be viewed as a quid pro quo—a political bargain. The deal defining the social role of charity has been struck.\textsuperscript{533} Charities have accepted the burden. The least that society can do is provide durable tax subsidies.

It is possible that the political bargain between the federal government and the charitable community preexists the reallocation and begins with the initial choice of entity (i.e., the decision to adopt the charitable form) as a bargain.\textsuperscript{534} Under this view, the entrepreneur or other relevant decision maker agrees to accept the nondistribution constraint in exchange for which the newly-created charitable organization expects durable tax subsidies. This characterization explains much of the behavior exhibited on the part of the charitable community whenever a change in the tax law is threatened, specifically the sense of betrayal and disappointment that the federal government is not living up to its end of the bargain.\textsuperscript{535}

The notion of a "bargain for durable tax subsidies" also rings true if one considers how an entrepreneur evaluates the various organizational forms available for a given enterprise. When considering the charitable form, the nondistribution constraint guarantees that any investment the entrepreneur makes must remain in the organization except to the extent that it is returned in the form of reasonable compensation.\textsuperscript{536} It also means that the entrepreneur agrees not to be able to share in any future profits. The charitable form exists in perpetuity. Upon dissolution of the organization, in accordance with its governing document, its assets must be distributed to other charitable organizations.\textsuperscript{537} Any funds invested by the entrepreneur or other interested individuals, as well as any profits, are thus said to be dedicated to charity. The entrepreneur must then balance these considerable restrictions against the "halo effect" that attaches to charitable organizations, the ability to solicit tax-deductible

\textsuperscript{533} See Hall, supra note 1, at 90 (noting the redefinition of the social role of the federal government).

\textsuperscript{534} In such case, the reallocation only increases the stakes of the bargain.

\textsuperscript{535} See, e.g., supra note 222 (describing the sense of confusion the federal government would create if it was to change the tax laws at a time when the executive branch was making various attempts to encourage private giving).

\textsuperscript{536} For a discussion of the prohibition on private inurement see supra text accompanying notes 91-93.

\textsuperscript{537} For a discussion of the requirement that the assets of a charitable organization must be dedicated to charity in perpetuity see supra note 65.
contributions, and the availability of other funding sources. Thus, when an entrepreneur chooses the charitable form and all its restrictions, he does so in reliance on the existence of favorable tax subsidies.

Current economic theories posit that charitable organizations form to correct for one form of market or government failure, and tax incentives are designed to encourage pre-existing behavior.\textsuperscript{538} The “bargain for durable tax subsidies” approach recognizes that the proliferation of charitable organizations has not occurred in a vacuum. It has occurred during a period when generous tax incentives for charitable activity were well established.\textsuperscript{539} The dual subsidies of tax exemption and the deductibility of contributions have become a material part of any choice of entity analysis rather than a little added incentive or friendly encouragement.\textsuperscript{540} Hundreds of thousands of organizations have been formed in reliance on these subsidies. In consideration therefore, they accepted a nondistribution constraint in perpetuity. From this perspective, it is understandable that any attempt to tinker with these subsidies would provoke outrage on the part of the charitable community.

VI. CONCLUSION

The notion that representatives of a particular industry can organize to influence Congress is a concept familiar to political scientists, economists, and many voters who have become cynical of the power of “special interest groups.” There is something disturbing, however, about thinking of charities as the equivalent of oil producers or dairy farmers. This is because of a widely-held belief that a strong charitable sector furthers the public good. It seems antithetical that charities would organize to advance their own self-interest.

The case studies show how the charitable community, motivated by its own sense of self-preservation, exercises its political muscle to influence federal tax policy.\textsuperscript{541} With the assistance of public choice and public interest analysis, this snapshot of the charitable community in

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\textsuperscript{538} For a discussion of the market or government failure theory see supra text accompanying notes 142-62.
\textsuperscript{539} For a discussion of the growth in charitable organizations see supra text accompanying notes 1-3.
\textsuperscript{540} When a choice is based on the tax considerations, economists refer to it as a distortion.
\textsuperscript{541} The areas of greatest concern are the deductibility of contributions and exemption from income tax. The case studies involve both. The § 861 Regulations threatened the deductibility of certain contributions from corporations with foreign operations. The sponsorship guidelines threatened to remove the exemption from income tax with regard to certain corporate sponsorship payments.
action helps us develop a stronger picture of the community and the intersectors shift in responsibility for social programs from government to charities. A combination of perceived economic exigencies, self-interest, and public interest have made this shift or reallocation highly attractive to policymakers. The rhetoric accompanying the reallocation, however, only further obscures our understanding of charitable organizations. It empowers charitable organizations to maintain their present level of government subsidies and forestalls meaningful public debate concerning the continuation of the subsidies and their appropriate level.

The public-regarding aspects of the reallocation, as opposed to the management opportunities offered to self-interested legislators, are based on a series of assumptions that only recently have been the subject of scholarly study. These assumptions are: (i) charitable organizations deliver social services more efficiently than government programs; (ii) charitable organizations "lessen the burdens" of government; (iii) tax subsidies are necessary to encourage individual volunteer and other charitable efforts; and (iv) tax subsidies are a cost-effective way to support such programs. As for the first two assumptions, the exemption is not tailored to reach only those activities that the federal government would otherwise perform. Moreover, the efficiency presumption does not consider that private firms could provide some of the services. The presumptions regarding the tax subsidies are also without much empirical support. For example, each year hundreds of thousands of individuals (nonitemizers) give to charitable organizations without receiving any tax benefit. Charles Clotfelter's recent study on the distributional effects of private charity suggests that charity does not primarily benefit the poor and disadvantaged.

542. Growth in the sector has greatly outpaced scholarly treatment. Recent efforts all remark on the relative lack of empirical and theoretical work in the area. See, e.g., BEN-NER & GUI, supra note 1, at 2-3; WEISSBROD, supra note 1, at 1 (referring to the nonprofit sector as "the commonly overlooked middle ground"); Clotfelter, supra note 319, at 1-3.

543. See supra note 135.

544. Part of this might be due to the prevalence of the market failure explanation for the formation of charitable organizations.

545. See generally SCHIFF, supra note 1.

546. Clotfelter, supra note 319, at 22. In addition, recent attempts to coordinate the benefit of tax exemption for charitable hospitals with their level of charity care have shown how difficult it is to measure the societal benefit produced by the charitable community. James B. Simpson & Sarah D. Strum, How Good a Samaritan? Federal Income Tax Exemption for Charitable Hospitals Reconsidered, 14 PUBG SOUTHS L. REV. 633, 634 (1991) (arguing that not all charitable hospitals "justify the loss of government revenue caused by their tax exemption").
For those who intend to pursue these outstanding issues, this Article makes two important observations. First, charitable organizations have coalesced to form an effective interest group, united by a common economic interest in maintaining certain tax subsidies. This newly-created interest group protects the favored tax status of the sector and, therefore, does not directly advance independent charitable goals. Second, the durability of charitable tax subsidies does not prove that legislators act to further either their private interest or the public interest. Either a public choice or public interest perspective can easily explain the durability of such subsidies provided one takes into account the emerging institutional role of charitable organizations and the political bargain under which they accept a greater burden and then demand durable tax subsidies in exchange. Indeed, the bargain regarding the durability of tax subsidies may be struck at the initial point in formation when the entrepreneur accepts the nondistribution constraint in reliance on the continued existence of favorable tax treatment.