Using Tax Law to Discourage Donor-Imposed Restrictions on Charitable Gifts

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Introduction

Charitable giving in the United States is widely celebrated and encouraged. Within the charitable giving community, annual giving totals are touted as evidence of Americans' generosity. A common theme in policymaking circles is to find ways to encourage more giving, and to view proposed changes to the federal charitable deduction through the lens of whether giving goes up or down.

A focus on increasing giving as a main policy goal, however, ignores many of the harder questions. As a society, we might be better off if our concern was not with *more* giving, but with *better* giving. *More* giving makes for a nice goal, because it is relatively easy politically to agree that more charitable giving is a good thing, even though more giving might not lead to improved outcomes. *Better* giving though does not allow for ready agreement. What would make giving better? The question evokes a need to reform current practice, not expand upon it. And with reforms there likely are winners and losers, often a recipe for policy stalemate.

This essay considers one way to make giving better. Americans may be generous, but often, that generosity comes with strings attached in the form of donor-imposed conditions on gifts, or "restricted giving." A restricted gift is when a donor imposes her will on the timing or use of donated cash or property by retaining or imposing some degree of control over donated funds. Restricted giving is a widespread practice; from a donor detailing specific uses, to demanding that funds be set aside in endowments, to delaying distributions through the use of donor advised funds. Yet restricted giving on the whole is

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inefficient and not in the general public interest. Restricted gifts tie the hands of the charity, turn public charities into vehicles for implementing private intent, and undermine institutional independence. Charities accept donor-imposed restrictions because half a loaf is better than none. But acceptance does not mean that a restricted gift is better than an unrestricted one, or that the law should not take sides.

This essay takes the view that one approach to better giving is to use the federal charitable giving incentive to discourage restricted gifts. The first part of the essay looks at the ways current law treats restricted gifts, disfavoring them in some cases, but remaining neutral in others. The second part explores why unrestricted gifts are better. The third part then looks at ways that tax policy might be used to nudge donors to give better by encouraging donors to release their generosity from the grips of the donor's living, or dead, hand. The essay concludes that tax law should be reformed to disallow a federal income or estate tax deduction for restricted gifts.

Part I. The Law of Restricted Giving

Unrestricted gifts are better. In various ways, the law already recognizes that donor restrictions are a nuisance. Nevertheless, the longstanding rule is to allow donor restrictions, and further, to mandate that charities abide by donor intent. This part of the essay explores the law of restricted giving from a property, trust, and a tax law perspective.

A. Property Law of Restricted Giving

The best place to start is with the idea of testamentary freedom and the alienability of property. A hard won property right, now taken for granted, is the right to dispose of property at death.[2] An owner may provide by will that her property descend to her heirs,

[2] John Locke believed that property ended at death. For centuries following the Norman Conquest in 1066, owners held only a lifetime interest (a life estate), with reversion to the King or other landlord at death. The fee simple estate, which is infinite, followed the Statute Quia Emptores of 1290, and eventually became the default, preferred, estate.

or anyone she chooses.[3] Thus, as every first-year law student knows, testamentary freedom means that property, as a legal construct, includes the right to dispose of resources over time. Similarly, during life, an owner may sell or give (alienate) property to whomever she pleases. To have property is to have power over the disposition and consumption of resources.

Related to the ability to alienate property at death or during life is a rule of construction that grantor intent be followed. This is because property can take many forms. An owner might transfer the whole property (the fee simple) or less than the whole (e.g., a fee simple determinable or a life estate). An owner may subject a transfer to a use condition, which, if violated, results in forfeiture of the property back to the owner (or the owner's heirs) or to a third party. Because the property system allows owners to fragment property rights in this way, when questions arise about ownership, a main role for courts is to interpret and follow the intent of the grantor. If the grantor intends an outcome that is against established public policy, such as a direct restraint on alienation, a court would not follow intent. But otherwise, the intent of the grantor, given the ability to fragment property, is the main lens through which courts adjudicate ownership disputes.

Also well known to law students, and to moviegoers (if vaguely),[4] testamentary freedom, and so grantor intent, is limited by the rule against perpetuities (RAP).[5] Under the conceptually complex RAP, the dead hand of the owner may control only the near future, generally within the lifetime of those alive at the owner's death, plus twenty-one years. But if the owner attempts to dictate dispositions too far into the future, the RAP strikes down the attempt as void. The RAP then is a limit on testamentary freedom, and donor control.[6]

[3] There are limits, including statutory protections for surviving spouses.
[4] Body Heat.
[5] Although the common law rule against perpetuities has been modified or repealed in many jurisdictions, it is still an important feature of the legal landscape and relevant to understanding the limitations of property.
[6] Thomas F. Bergin & Paul G. Haskell, Preface to Estates in Land and Future Interests 178 (2d ed. 1984) ("The rule against perpetuities is the principal means which the Anglo-American system of law has employed to limit the power of an individual to control the disposition of his wealth after his death.").

The reasons for a rule against perpetuities are several. As a matter of economy, contingent future interests restrain the movement of resources (alienability). Naturally, when property is subject to a future interest, present buyers balk, not willing to risk investment in property that will cease to be theirs upon the occasion of some future event.[7] Indeed, for many owners, making property inalienable was the reason to impose a future interest – to keep real property in the family, for generations. Relatedly, it can be said that an owner's vision for the use of property has relevance only to the extent the owner can recognize the future. The more remote the disposition, the less likely the owner has a sound understanding of a property's optimal use, suggesting a time limit.

As is often the case, moral reasons for the RAP complement the economic. Property rights represent a grant of private power, enforced by the state. At some point, there must be a limit to this grant. Over time, to honor the wishes of the dead over the needs of the living is odious. Property rights, though "private," ultimately serve human values. Property is a social construct, tied to the reasonable expectations of people who use resources. As time passes, and the interests of the past recede, the expectations of the present generation become stronger than honoring the wishes of those long since dead. Thus, if abiding by the will of a single person conflicts with the wider social good, the broader interest should prevail. In this way, the RAP is an outer limit on the very concept of property.

Another less well known rule, but significant in the context of restricted giving, is the rule against accumulations.[8] Directed to a slightly different vice than the RAP, the rule against accumulations regulates an owner's control of how long property can be held in abeyance before being vested in possession (or paid out). The rule against accumulations developed in response to public outrage over a will that required property to be accumulated during the lives of the testator's nine heirs, and distributed upon the last to die.[9] The will, which was upheld, led to statutory reform barring accumulations for periods longer

[7] This concern is remedied when property is given in trust and the trustee has the power to alienate the property, meaning that property remains in consumption even while the beneficiaries are determined pursuant to the settlor's plan.
[8] *See* Robert H. Sitkoff, *The Lurking Rule Against Accumulations of Income*, 100 NORTHWESTERN LAW. REV. 501 (2006).
[9] Thellusson v. Woodford, 4 Ves. Jr. 227 (1798), *aff'd*, 11 Ves. 112 (1805).

than would be allowed under the RAP. The concerns were that accumulations could lead to a vast stockpiling of wealth as well as with intergenerational equity.[10]

The property law limits on grantor restrictions, however, generally do not apply to charitable transfers. The reasoning is straightforward. Charitable transfers are not thought to present the same concerns as private transfers because when property is transferred to charity, the property is converted, in theory, from the private to the public sphere, or from a private and selfish use, to a more public one. There thus appears no obvious reason to apply conventional limits to charitable transfers.[11] In addition, given a choice of use, the default for many owners is to keep property in the family. By allowing an exception to the RAP for charitable transfers (and to the rule against accumulations),[12] property law encourages owners to become donors.

By way of summary, under the default rules of property law, an owner has considerable power to dispose of resources and impose his will well into the future, subject to

[10] The stockpiling of wealth concern has been largely dismissed through experience (e.g., the trust at issue performed poorly over time and not much was accumulated). Both the RAP, and correspondingly, the rule against accumulations (which was in any event less well established), have been attacked in recent years as States have repealed the RAP largely at the behest of institutional trustees marketing perpetual trusts for their tax benefits. Jesse Dukeminier & James Krier, *The Rise of the Perpetual Trust*, 50 UCLA L. REV. 1303 (2003).

[11] The charitable exception to the RAP allows, for example, a gift "to Charity 1 for church purposes, but if not used for church purposes, to Charity 2." Without an exception, the RAP would strike down the gift to Charity 2 as vesting too late. In addition, charitable trusts are allowed in perpetuity. To modern sensibilities, a presumption that charitable transfers are for the public benefit seems axiomatic. Historically, however, the law actively discouraged transfers to charity through Mortmain Statutes. In feudal times, owners, and their heirs, were seen to be in need of protection from ardent death-bed solicitations, especially by the church. Further, once property was transferred to a charity in corporate form, feudal incidents that were levied on transfer (a form of taxation) would be avoided in future because a corporation, unlike an individual, has perpetual life. *See* Evelyn Brody, *Charitable Endowments and the Democratization of Dynasty*, 39 ARIZ. L. REV. 873 (1997).

[12] According to Bergin & Haskell, the common law rule against accumulations has not been applied to accumulations for charitable purposes. Charitable accumulations "are limited only by the standard of reasonableness." Bergin & Haskell, *supra* note 6, at 224. *See also* Lewis M. Simes, Public Policy and the Dead Hand, The Thomas M. Cooley Lectures 114 (University of Michigan Law School 1955). ("It has many times been recognized by American courts that a direction for an accumulation for charity is not void because it may continue longer than lives in being and twenty-one years; but that the only restriction which the law imposes on the duration of an accumulation for charity is that a court of equity may supervise it, and in its discretion, may order its termination.").

limitations imposed by public policy, and by the rules against perpetuities[13] and accumulations. For charitable transfers, however, normal limitations do not apply.

B. Following Donor Intent

The rule of construction to abide by grantor intent becomes a part of core legal doctrine when the grantor is a charitable donor. For charities subject to donor restraints, there is a high bar to change the donor's will. As Professor Susan Gary puts it, "[t]he law requires charities to comply with donors' restrictions."[14]

Applicable law depends in part on whether the charity is in corporate or trust form. Notwithstanding that corporate charities are far more numerous,[15] trust law provides the foundation for understanding the rules enforcing donor intent. In either case the general rule that donor intent must be followed is enforced by imposing legal duties on those in charge of the corporation (charitable managers) or trust (trustees).

In the first instance, trust law imposes a duty of obedience on the trustee "to carry out the purposes of the trust."[16] Thus, if a donor imposes a restriction, the trustee's duty includes an obligation to follow the terms of the restriction.[17] Corporate law imposes a similar duty.[18]

Donor restrictions are not immutable, however. Because a charitable trust is perpetual, rules at common law developed to allow the release of donor restrictions to account for the passage of time. Thus, under the doctrine of *cy pres*, meaning "as close as possible," a charitable trust may stray from a donor's intent, but only if the intent of the

[13] The common law RAP allowed some contingent interests to escape. For example, if violation of a use condition resulted in forfeiture to the original grantor (as in a fee simple determinable), the RAP did not apply. Future interests in the grantor were (and are) considered vested and not contingent.
[14] Susan N. Gary, *The Problems With Donor Intent: Interpretation, Enforcement, and Doing the Right Thing*, 85 CHI-KENT L. REV. 995 (2010). *See also* Brody, *supra* note 11 at 880 (noting that "American law still grants enormous deference to donor-imposed conditions").
[15] As Professor Gary notes, the trend is to merge the two areas of law "with the application of corporate fiduciary principles to trustees of charities organized as trusts and the application of trust law modification rules to restricted gifts to nonprofit corporations." *Id*. at 996-97.
[16] *Id*. at 997.
[17] "As long as the trust qualifies as charitable, courts will hold the trustee to these terms no matter how confident the parties are that a better use could be made of the funds." Evelyn Brody, *The Limits of Charity Fiduciary Law*, 57 MARYLAND L. REV. 1400, 1422 (1998).
[18] Gary, *supra* note 14, at 997 (noting that case law "applie[s] different legal rationales to reach this result").

donor has become unlawful, impossible, or impractical to carry out, among other requirements.[19] *Cy pres* may not be undertaken unilaterally by a charity but requires court approval[20] and involvement of the state attorney general, and thus can be costly and difficult to obtain. Even when a change is allowed, the new purpose or use must take into account the original intent of the donor.[21]

Another doctrine, equitable deviation, allows a charity to ask a court to change an administrative term of a trust. Unlike cy pres, equitable deviation directly furthers donor intent. This is because the doctrine generally applies when administrative requirements imposed on the trust by the donor turn out to threaten the donor's original purpose.[22] Thus, a change is needed to implement the donor's intent.[23]

Courts apply cy pres and equitable deviation whether the charity is in trust or corporate form. Notably, the very existence of both doctrines points to the strength of the default rule that donor intent must be followed.[24]

Most importantly here, abiding by grantor or donor intent is a natural outgrowth of a property system that allows the fragmentation of ownership. Once the law admits to the validity of owner-imposed conditions, upholding those conditions, within reasonable limits, is simply a matter of legal logic. Further, in the case of charitable transfers, where the regular limitations do not apply, yielding to donor intent reflects a belief that doing so helps to encourage owners to part with their property and that otherwise applicable limits

[19] The (paraphrased) historic three part test to allow a change required: (1) a gift for valid charitable purposes, (2) where the intent of the donor or settlor had become impossible, impractical, or illegal to carry out, and (3) the donor or settlor had a general charitable intent. *See* Marion R. Fremont-Smith, GOVERNING NONPROFIT ORGANIZATIONS: FEDERAL AND STATE LAW AND REGULATION 173-86 (2004). The Uniform Trust Code has added wasteful to the list, and omitted the need for courts to find a general charitable intent of the donor. UNIFORM TRUST CODE § 413. *See also* Harvey P. Dale, *Controlling Donor Intent*, this volume.
[20] "Courts have tended to apply cy pres narrowly, giving significant deference to donor intent." Gary, *supra* note 14, at 1023. The Uniform Trust Code takes a liberal approach (new use must be "consistent with the settlor's charitable purposes").
[21] The literal requirement of "as near as possible" need not be strictly applied. The Third Restatement of Trusts acknowledges that courts may require just that the new purpose be "reasonably similar" to the original one. §67 cmt. d.
[22] UNIFORM TRUST CODE § 412.
[23] The Uniform Trust Code also allows equitable deviation if existing terms "would be impracticable or wasteful or impair the trust's administration." *Id.*
[24] *See also* Gary, *supra* note 14, at 999-1000.

on conditions are less important because any condition by definition is serving a public good. The result is that donors to charity may extend their wishes and eccentricities far into the future, so long as the gift is charitable in nature.

C. Tax Law and Concern about Donor Involvement

As a general matter, tax law inherits the baseline rules of property (and charitable trust) law that donors may impose conditions on the use of property and that donor intent must be followed. But as discussed in more detail below, tax law also attempts in numerous ways to restrain the donor in favor of the charity. In fact, although rarely conceived of in this way, much of the federal tax law of charities can be explained as a resistance to the default property rule that donor-imposed property restrictions are allowed.

The tax system plays two distinct roles with respect to charitable transfers. On the one hand, tax rules favor charitable giving, facilitating hundreds of billions of dollars of transfers to charity annually. On the other hand, tax rules require compliance, both by donors to secure tax benefits, and by organizations to become and remain eligible for tax-favored status. A dominant theme that surfaces in these dual roles is that a main function of tax law is to oversee the relationship between charities and donors. Donors have an inclination to want to retain some semblance of control over gifted assets; tax law protects charities from donor controls.

(i) *Tax incentives and compliance, in general*. First it is helpful to glimpse the role tax law plays in encouraging charitable transfers. Two important parts of the federal tax system bear on transfers to charity – the estate and the income tax. Under the estate tax, the decedent is allowed an unlimited charitable estate tax deduction, meaning that charitable transfers from an estate reduce estate tax by the amount of the transfer. For the very wealthy, a desire to avoid estate tax can encourage charitable gifts, including the creation of private foundations (typically controlled by the decedent's family), donor-advised funds, or other legacies at established charitable institutions. Of the $373.25 billion of total charitable giving in 2015, $31.76 billion was by bequest.[25]

[25] GIVING USA 2016: ANNUAL REPORT ON PHILANTHROPY FOR THE YEAR 2015, 18.

Separately, under the income tax, donors who itemize deductions are allowed a charitable contributions deduction to reduce their taxable income, subject to a wide variety of limitations. The charitable deduction is one of the largest tax expenditures in the Code, representing $260.1 billion of government expenditure over five years.[26] Of the $373.25 billion of total charitable giving in 2015, $264.58 billion was individual inter-vivos giving.[27] In addition, the Code provides exemption from federal income tax (among other benefits) for organizations eligible to receive deductible contributions.

Both the estate and income tax regimes thus foster the diversion of assets from the private to the charitable sector, and reflect longstanding public policy that giving is in the public interest and should not increase a donor's tax burden. In short, the tax system encourages donors to give.

The flip side of encouraging charitable gifts is the responsibility of ensuring that gifts are used appropriately. Because deductions are allowed for "charitable" transfers, the tax system must define charity. Charity obviously cannot be left to individual whim, or any routine gift arguably could become charitable, and deductible, eroding the tax base. In the words of Lewis Simes, however, "[n]o satisfactory legal definition of a charity has ever been made."[28]

The difficulty in defining charity for tax purposes has meant that over time an elaborate system of rules has developed that defines charity in form rather than substance. The main point of the system is to make it more likely than not that when the rules are followed the public interest will be served by the transfer.

In simplified form, the broad components to the charitable transfer system are that: donors must relinquish dominion and control of the gifted property, donors must take into account benefits received or retained in connection with gifts, and the gift must be to a

[26] STAFF OF THE JOINT COMMITTEE ON TAXATION, ESTIMATES OF FEDERAL TAX EXPENDITURES FOR FISCAL YEARS 2015-2019 36, 38 (2015).
[27] Giving USA Report for 2015, *supra* note 25, at 18.
[28] *See* Simes, *supra* note 12, at 118.

qualifying organization.[29] To varying degrees, each of these components is designed to promote a positive outcome (charity) by excluding a negative (not charity), and are worth examining briefly.

(ii) *Completed gift*. At the outset, the law requires a completed gift. Property must in fact be gifted over to the charitable sphere. If the donor retains "dominion and control" with respect to property in a charitable transfer, there is no gift for tax purposes (i.e., no charitable deduction). Thus, formal legal control of property must be vested in the donee charitable organization.

Although the completed gift rule seems obvious, the presence of the rule is instructive. Fundamentally, the charity and not the donor must be the legal owner in order for the charitable transfer system to make any sense. The charity, not the donor, is organizationally committed to serving the public interest, in perpetuity.[30] Donors are fully capable of serving the public interest as individuals by direct spending. But if a tax deduction is involved, the public good by definition is conducted through distinct and independent entities. Donors must, at the outset, cede dominion and control of property to a charitable entity.

The completed gift rule also points to donor tendencies not to want to give up control of property. As former owners, donors naturally may continue to feel possessive over what was once theirs and seek control. The completed gift rule therefore provides charities with leverage in negotiating gift agreements. For example, a requirement to seek a donor's approval prior to spending donated funds, or hiring employees, or deciding whether to undertake a project likely would run afoul of the completed gift rule. Softer forms of donor involvement are permitted – such as consulting with donors prior to decisions – but the decision about how to use donated monies must rest with the charity not the donor.

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[29] There must also be a "gift." There is no settled definition of a gift. The nuances are not explored here, though whether a transfer constitutes a gift is related to the completed gift and quid pro quo rules discussed *infra*. For general discussion of the meaning of gift, *see* Bruce R. Hopkins, THE TAX LAW OF CHARITABLE GIVING, § 3.1 (4th ed. 2010).

[30] A related rule on the organization side relates to perpetuity. Once property unequivocally passes into the charitable sphere, the property must forever be dedicated to public purposes. This is secured by a requirement that charities provide in organizational documents that upon dissolution all assets will be distributed for charitable purposes. Treas. Reg. § 1.501(c)(3)-1(a)(4).

Although the completed gift rule is fundamental and important, donors who are determined to retain effective (or actual) control over donated property are able to do so notwithstanding the completed gift rule. One example is in the context of donor advised funds. With a donor advised fund, donors cede formal legal control over property donated to a separate charity, but retain an ability to provide advice about how the money is spent. Consistent with donor expectations, the advice typically is followed by the charity as a matter of course. The completed gift rule is satisfied so long as the charity has the power to refuse the donor, even if the power is never exercised. Indeed, the success of donor advised funds as a charitable giving vehicle is based on the legal fiction that donors do not control fund distributions.

Another, even more direct way around the completed gift rule, is through choice of charitable entity. Donors may vest ownership of property with an entity and so make a completed gift, but nonetheless still directly control disposition of the property by controlling the entity. This commonly occurs through the private foundation.[31] Donors fund a foundation they create, control the foundation, and arrange that control of the foundation remain in the family. The gift is complete, property is dedicated to charity in perpetuity, but the donor and the donor's heirs control the charitable assets.

In general, the completed gift rule is an essential part of the charitable transfer system. However, at bottom the rule is formalistic. Donor advised funds and private foundations are just two, albeit established examples.

(iii) *Return benefits, retained rights, partial interests, and "property."* Another fundamental component to the charitable transfer system is that benefits donors receive or retain in connection with a gift must be taken into account in determining the charitable deduction. The extent to which a charitable deduction is allowed depends upon whether, as part of a charitable contribution, there is a return benefit to the donor, a donor-imposed condition that affects value, or a retained right of the donor.

[31] Donors also can form and control a non-charitable entity, in which case the charitable transfer system is not involved. The leading recent example is the LLC created by the Chan-Zuckerberg Initiative.

In most simplified form, not only must a gift be complete, there must also be a net gift. If a donor gave $100 cash and received $100 of noncash benefits in return, clearly the donor should not, and would not, be allowed a charitable deduction. In reality, the rules are more complex. In the case of return benefits, a charity may in exchange for a contribution provide a return benefit to the donor, but the donor must reduce the amount of the gift by the value of the return benefits received when determining the deduction. Thus charities may and do offer all sorts of inducements to donors to get them to give. De minimis return benefits are ignored.[32]

The "quid pro quo" rules are straightforward when return benefits are fairly easy to value and identify, like tickets to an event, or a tote bag. When return benefits are difficult to value or opaque, however, application of the rule is more difficult. For example, if a donor makes a contribution of real estate and in return the charity agrees, as part of developing the real estate, to build a road that benefits the donor, then a deduction can be barred altogether as a substantial return benefit.[33] The right to name a building, or other forms of donor recognition, are viewed as return benefits, but generally ignored, even though donors clearly highly value and benefit from having their names etched prominently in stone.[34] In principal though, any return benefit to a donor, tangible or not, should be taken into account in determining the charitable deduction.[35]

Some use restrictions could be considered as return benefits, but are not. Conventionally, to accept a donor-imposed restriction on property, such as that donated property be held in an endowment, is not viewed as a return benefit, but a use restriction consistent with a donor's exercise of property rights. Whether or not a return benefit, use restrictions arguably are taken into account under present law through the rule that the charitable deduction is for the property contributed. If donated property is substantially affected by a donor restraint, then the value of the property contributed will be less than without the donor restraint, and the use restriction will be netted out.

[32] Rev. Proc. 90-12, 1990-1 C.B. 471.
[33] Ottawa Silica Co. v. United States, 699 F.2d 1124 (Fed. Cir. 1983).
[34] *See generally* William A. Drennan, *Where Generosity and Pride Abide: Charitable Naming Rights*, 80 CIN. L. REV. 45 (2011).
[35] Proposed changes to current law are discussed *infra* Part III.

For example, a donor-imposed restraint that undeveloped real property remain undeveloped, even though the property is located in a prime development area, would adversely affect the value of the contributed interest. The no development use restriction would be taken into account in determining the amount of the deduction. Technically, the use restriction may not be a return benefit, but it amounts to the same thing in either case. The deduction is for the value of the contributed property, as adversely affected by the use restriction. By contrast, if a donor-imposed restraint on a $1 million gift is that the money be invested and held in an endowment, the deduction would be $1 million. In this case, the use condition would not affect the underlying value of the asset, nor would it be viewed as a return benefit.

When a use restriction affects the property in a formal sense, i.e., when the use restriction formally is considered a retained property right, tax law takes yet another approach. Under the partial interest rule, a donor is not allowed a deduction unless the donor gives the donor's entire interest.[36] In general terms, this means that if the donor owns the fee simple, the donor must give a fee simple. Strictly applied, the donor may not fragment the property by, for example, giving a present interest (e.g., a fee simple determinable) and retaining a future interest (a possibility of reverter).[37] In other words, when use conditions or donor restraints result in the formal retention of a property right (like a future interest), then *no* deduction is allowed.

The contrast with the quid pro quo rules is stark. In the case of a return benefit, the deduction is allowed but reduced by the value of the return benefit. In the case of a donation of a partial interest and a retained right, the deduction is not allowed in any amount – even though the charity may hold valuable property.

The drastically different outcomes can be understood by considering the nature of return benefits and partial interests. If a return benefit is involved, there are in effect two transactions: the donor parts with property, and in exchange, the charity parts with property. Netting out the difference yields the charitable portion of the two transactions. If a

[36] I.R.C. § 170(f)(3).
[37] The regulations allow a deduction for a fee simple determinable if the likelihood of the forfeiture event is so remote as to be negligible. Treas. Reg. § 1.170A-7(a)(3).

partial interest is involved, there is one transaction. The donor parts with property, but retains some interest in that property. It is the fact that the donor retains a property right that has significance for tax purposes and accounts for the different tax treatment (a netting out, versus a disallowance).

Historically, a retained right was problematic for two reasons: valuation, and concerns about double tax benefits. Valuation of a partial interest presents problems because there generally is no exchange value for partial interests, leaving too much to donor discretion and too great a risk of overvaluation. The double tax benefit appears when the donor is allowed a deduction but has not actually given anything away. For example, in the case of allowing a charity to use rental property, even though the charity receives something valuable, the donor, by giving up the use of the property, essentially assigns the rental income that the donor would have received to the charity. Allowing a charitable deduction for the assignment would essentially amount to a double deduction: the donor would avoid the income, plus get a deduction for the avoided income.

Although these are the two articulated reasons for the partial interest rule, the rule also points to tax policy concerns about donors not giving up their interest in property. A retained right means that the private interest of the donor must co-exist with the public interest of the charity, and the two interests might not always align.

There is no better example than in the main exception to the partial interest rule: contributions of conservation easements, an area rife with problems.[38] One of the main difficulties is directly related to the reason for the ban on partial interest contributions: the retained rights of donors can affect future use decisions by charities. If the donor continues to own the fee interest, over time, the donor (or the donor's successor) might want to develop the property in a way that is not consistent with the conservation easement. The donor also may have specific ideas about how the property affected by the easement should be used by the charity. As a result, easement donations are remarkably complex, negotiat-

[38] Normally, the contribution of an easement when the donor also owns the underlying fee would be the contribution of a partial interest and no charitable deduction would be allowed. If the easement is exclusively for conservation purposes, however, then the deduction is allowed (generally equal to the difference in the value of the property before and after the contribution). I.R.C. §§ 170(f)(3)(B)(iii), 170(h).

ed agreements, and costly to enforce.[39] As an exception to the bar on partial interest contributions, conservation easements help to illustrate the reason for the rule in the first place.

In sum, the charitable deduction rules first require a completed gift. Then, the question is to identify the property given, taking into account return benefits and retained rights,[40] with different approaches for each. In either case, where a donor interest or benefit is shown that is not de minimis, the rule of law is to reduce or eliminate the amount of the charitable deduction allowed.

(iv) *Qualifying organizations*. The third broad component of the charitable transfer system is that gifts be to a qualifying organization. The qualifying organization requirement provides the backbone of the transfer system. The best-known type of qualifying organization is described in section 501(c)(3) of the Code, and includes those "organized and operated exclusively" for charitable, educational, religious, scientific, or literary purposes.[41] These various "exempt purposes" are often reduced to one catch all purpose – "charitable" – to describe a vast sector of hospitals, colleges and universities, schools, museums, foundations, social service organizations, animal rights groups, foreign aid groups, among many others.[42]

A comprehensive summary of the law is well beyond the scope of this essay. The point here is to provide an overview of the ways in which the law of 501(c)(3), through the qualifying organization requirement, is concerned about donor involvement and use of

[39] A related, and often litigated issue is the problem of valuation, one of the cited reasons for barring partial interest contributions. When the donor retains the right to use the fee property, it is not clear that anything of value has been relinquished. *See* Daniel Halperin, *Incentives for Conservation Easements: The Charitable Deduction or a Better Way*, LAW & CONTEMP. PROBS., Fall 2011; Roger Colinvaux, *Conservation Easements: Design Flaws, Enforcement Challenges, and Reform*, 33 UTAH L. REV. 755 (2013).
[40] Fractional giving provides yet another example. Unlike the gift of a partial interest, with a fractional gift, the donor parts with a complete fraction of the property. For example, if the donor owns 100 percent, the donor gives 25 percent. In property terms, a fractional gift is a gift of a concurrent interest like a tenancy in common. An abuse of fractional giving occurred in the context of art donations. Some art owners would give percentage interests in a painting to a museum, which included the right of possession. The museum need not ever possess the painting, and the donor continued to reap the benefits of ownership. Congress enacted strict anti-abuse rules to quell the practice.
[41] Section 501(c)(3) demarcates private and quasi-public spheres of action. Charity broadly represents the private provision of the public good.
[42] In this essay, the term "charitable" organization includes all of these other organizations.

charitable assets for private purposes. In contrast with the completed gift and return benefit-partial interest rules, which are intended directly to take into account donor entitlements, the qualifying organization rule is relevant to how the law polices the charity-donor relationship in light of the ability of donors to place restrictions on, or have influence over, gifts.

Most, if not all, of the law of 501(c)(3) is directed to one end: securing public benefit. As noted, a broad, purpose-based definition of charity means that public benefit is enforced indirectly through the regulation of activity generally thought to present a risk to the charitable enterprise. Indeed, keeping private or selfish conduct out of the public charitable sphere is the central regulatory approach that drives much of the charitable transfer system.

As an initial matter, the law fundamentally, if vaguely, instructs that a 501(c)(3) organization must be organized for the public interest, not for a private interest.[43] Donated assets must be used for the public interest. Private influences, including by donors, potentially are problematic. If an organization appears to be set up for the benefit of private interests, then 501(c)(3) status fails. Equally fundamental, all 501(c)(3) organizations are prohibited from private inurement, which means that charities operate under a rule that diversion of assets for the private use of organization insiders, which can include donors, is not allowed.[44] Both the no private benefit and no private inurement rules are consistent with donor restrictions on gifts, but serve as reminders that ultimately, any gift must be for the public good.

In addition to these broad prohibitions regarding private influence, concerns about donor control over charitable assets play a major role in the section 501(c)(3) taxonomy. Section 501(c)(3) organizations are divided into "public" and "private" categories. The "private" charity, better known as a private foundation, in essence is a donor-controlled

[43] Treas. Reg. § 1.501(c)(3)-1(d)(1)(ii).
[44] I.R.C. § 501(c)(3). The prohibition on private inurement is enforced either through loss of (c)(3) status, or through excise taxes on "excess" benefits, I.R.C. § 4958, or, in the case of a private foundation, on "self-dealing." § I.R.C. § 4941.

charity that makes grants of the donor's contributed funds.[45] Because charitable use assets are subject to continued donor control, there is a heightened risk that the assets will be used to serve private not public purposes. Accordingly, Congress imposed an extensive regulatory regime on private foundations; including excise taxes on self-dealing with donors and other insiders, the use of charitable assets for private purposes (including to benefit donors), and excess holdings in a business (often, the donor's).

Relatedly, donor control, or lack thereof, plays a leading role in paving the way for the public charity status of community foundations. A community foundation (organized in trust form) escapes "private" status if, among other things, donors do not place material restrictions on donated funds and the community foundation adopts a variance power that allows the foundation to deviate from donor intent. Freedom from donor control of assets thus was critical for the public charity status of the community foundation.

In addition, private charity, especially in the context of grant making, raises concerns that donor-controlled assets will be accumulated and not spent. Accumulations raise questions both of dead hand (or donor) control over spending decisions, and also of intergenerational equity. In the private foundation context, concerns such as these eventually led to an annual pay out requirement.[46] Moreover, the policy concern about accumulation of charitable assets is and was not limited to the foundation context. Donors to public charities often require or enable the accumulation of assets. Funds earmarked for a university endowment is one example. Donor advised funds are another.[47]

Finally, private charity is disfavored relative to a public charity in the charitable deduction rules even though both are qualifying organizations. First, gifts to private founda-

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[45] A typical private foundation is funded by a large contribution from a wealthy donor, who then controls the foundation. *But see*, the Trump Foundation.

[46] I.R.C. § 4942. The required payout is roughly equal to five percent of the value of non-charitable use assets. At the time the payout was imposed, many in Congress wanted to go further, and limit the life of private foundations. The payout was a compromise, and initially was set at a higher percentage than currently.

[47] Notably, before imposition of the private foundation payout, the common law property rule against accumulations had a counterpart in the tax Code. Prior to 1969, there was an excise tax on unreasonable accumulations of charitable assets. Today, in many states, the Uniform Prudent Management of Institutional Funds Act ("UPMIFA") governs management of funds irrespective of whether the funds are held by public or private charities. UPMIFA deems spending above a rate of seven percent as imprudent – a presumption that may be rebutted. *See* Susan N. Gary, *Charities, Endowments, and Donor Intent: The Uniform Prudent Management of Institutional Funds Act*, 41 GA. L. REV. 1277 (2007).

tions are capped at a lower level. Second, the amount that may be deducted for certain types of property is less than gifts to public charities. Although the reasons for disfavoring private foundation giving may be debated, both limitations are tied to the idea that for private charity, donor influence is a menace to be circumscribed.

In summary, the qualifying organization requirement generally is designed to keep out private, selfish conduct. The private benefit doctrine, the ban on private inurement, the far more intrusive regulation of donor-controlled charities, and the different treatment of charitable contributions for private and public charities, all illustrate the ways in which the tax law indirectly promotes the public good by regulating circumstances that might lead to private gain.

* * *

To summarize this Part, property law provides the basis for donor restrictions on property transfers. The power of owners to fragment property into present and future interests, and to impose conditions on the use of property is long established, subject to rules against perpetuities and accumulations. A corollary of fragmentation is a rule of construction that grantor intent generally must be followed, unless the intent is contrary to public policy. In the charitable context, property law rules against perpetuities and accumulations do not apply, and donor intent must be followed. Donors therefore have significant sway over charitable transfers.

Federal tax law is overlaid on property law's foundations. The tax law facilitates charitable transfers with tax incentives, but also regulates charitable transfers to ensure that the public good is served. Tax regulation aims broadly to promote the public good by restraining private or selfish conduct. Through the completed gift rule, rules on return benefits and retained interests, and by extensive regulation of organizations that are eligible to receive deductible contributions, the tax law is demonstrably resistant to donor control and influence over charitable use assets as circumstantially contrary to the public good.

Part II. Unrestricted Gifts are Better

Donors may and do restrict gifts in a variety of ways. The main categories are restrictions as to use or purpose, restrictions as to time, or facially unrestricted gifts that are intended to be used for the charity's current purposes.[48] Clearly, donors like to impose restrictions, and charities yield to them. Yet what is the reason for allowing restricted gifts? As Part I showed, restricted gifts are largely a by-product of property law. Should tax law continue to tolerate restricted gifts as part of the charitable transfer system?

The overwhelming consensus is that restricted gifts are second-class gifts. Although not quite on a par with the Declaration of Independence, it would seem to be a self-evident truth that given a choice, a charity would prefer an unrestricted to a restricted gift. Unrestricted gifts allow the charity full discretion over use of charitable assets. Restricted gifts on the other hand mean that the charity must heed the donor's will in making decisions. In individual cases, and with hindsight, it may turn out that a donor is a better judge of public benefit than the charity. But as a general matter, the charitable transfer system is based on the premise that institutions, not individuals, are and should be the locus for determining public benefit.[49] Further, instances of eccentric donors insisting on uses of dubious public good abound.[50]

Moreover, restricted gifts are not costless. As others have argued, restricted giving is inefficient.[51] Restrictions represent a use decision made at one point in time, based on information available at the time of gift. Even assuming the initial choice is sound, as time passes, information changes along with society's needs. Restrictions stand like monuments to the past, and impede optimal use decisions. The longer in time the restriction, the

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[48] *See* Gary, *supra* note 14, at 995.

[49] This is not to imply that the law should not also nudge institutions to perform optimally. Indeed, to focus on restricted giving is to focus on one-half of a problem. The other half is when charities decide to accumulate excessively, without regard to donor intent. This essay is concerned more with at least giving charities the ability to make a mistake.

[50] *See e.g.,* Simes, *supra* note 12, at 119-120 (listing narrow charitable purposes approved by courts); Lawrence M. Friedman, A SOCIAL HISTORY OF WILLS, TRUSTS, AND INHERITANCE LAW 152-161 (2009) (describing a series of cases).

[51] Adam J. Hirsch & William K.S. Wang, *A Qualitative Theory of the Dead Hand*, 68 IND. L. J. 1 (1992) ("efficiency will dictate some finite limit on the life of a use restriction"). *See also* Dukeminier, *supra* note 10; Brian Galle, *Pay It Forward? Law and the Problem of Restricted-Spending Philanthropy*, __ WASH. U. L. REV. __ (forthcoming 2016).

greater the cost.[52] As Professor Hansmann wrote about endowments, time limited spending restrictions are a "conservative drag on future resources."[53]

Relatedly, restricted gifts crowd out other necessary spending. As Professor Gary puts it, with more restricted gifts, "the amount of unrestricted money may be insufficient to take care of the charity's existing needs. As more donors choose restricted over unrestricted gifts, money to support operating expenses and general program expenses becomes harder to find."[54] By contrast, "[t]he fewer restrictions placed on funds received by a charity, the greater flexibility the charity will have in meeting its operating costs, developing new programs, and managing all of its funds in an efficient manner."[55]

Along similar lines, Professor Brian Galle laments the opportunity cost of perpetual restrictions, noting that if spending is time limited, the charity deprives itself, and so society, of the benefits of learning from its mistakes.[56] Although Professor Galle expresses this concern in the private foundation context, opportunity cost has some applicability to restricted giving generally, especially where restricted gifts crowd out general purpose gifts, thereby denying the organization the opportunity to probe beyond donor intent.

Apart from inefficiency, commentators identify a litany of other costs from restricted giving. Famed philanthropist Julius Rosenwald argued that perpetuities (in the form of donor restrictions) undermine the charitable institution by "express[ing] a lack of confidence in trustees" and "encourag[ing] the build-up of bureaucracies."[57] Professor Evelyn Brody highlights a similar concern, noting that perpetuities reinforce private aims, and can convert a public-facing institution into one that serves a private will, or its own existence over that of beneficiaries.[58] In addition, the carrying cost of donor restrictions should not

[52] Hirsch and Wang, *supra* note 51, at 21 (noting that the longer a restriction the more the world "diverges from the [donor's] expectations," and the smaller the benefit to the donor as beneficiaries become those unknown to the donor).
[53] Henry Hansmann, *Why Do Universities Have Endowments?*, 19 J. LEGAL STUDIES 3, 32 (1990).
[54] Gary, *supra* note 14, at 1030.
[55] *Id.*
[56] *See* Galle, *supra* note 51. Galle also critiques time-limited giving on the ground that the future will be more prosperous so it short-changes the present generation to wait.
[57] *See* Brody, *supra* note 11, at 923 (quoting Rosenwald).
[58] *Id*. Professor Brody and others when discussing "perpetuity" sometimes are describing the perpetual life of foundations and problems that arise, and not restricted giving per se. Sometimes perpetual life of founda-

be ignored: restrictions mean that donor funds must be segregated and tracked, and donor intent must be interpreted, and occasionally, litigated.[59]

Further, and more broadly, restricted giving should be seen for what it is: dead hand control, which, though long tolerated, has also long been viewed as a "socially undesirable" objective.[60] The dead hand control of charitable use assets permits "the vanity of the dead capitalist [to] shape the use of property forever," a power "far beyond that which is possible anywhere else in the law."[61] Thus, a generic social ill is permitted in the charitable transfer system, but not elsewhere.

The standard reason is that, notwithstanding that an unrestricted gift is better than a restricted one, a restricted gift is better than no gift. Thus, if public benefit is measured by total giving, and not on the basis of which gifts charities would prefer, it could be argued that restricted gifts are a reasonable price to pay for more overall giving. In the words of Lewis Simes, the law strikes a bargain, saying to donors: "If you will dispose of your property within the broad area known as charity, then a public benefit is presumed; and, in exchange for that public benefit, you are permitted to determine the future disposition of your property without limitation as to time."[62]

The historic bargain over restricted giving is based on this presumption of public benefit. The presumption still operates strongly in the law, but it should be viewed with a critical eye. The presumption has intuitive appeal: donors make completed gifts to charity, which by definition are public benefit organizations. Writing in the 1950s, Simes believed, however, that the presumption of public benefit was weak, in large part because the legal definition of charity necessarily is broad. But a broad definition makes it more likely that charity under law serves incrementally more private than public ends. Because of the peril

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tions and restricted gifts raise similar issues, to the extent the question is abiding by donor intent. But foundations also raise a distinct set of issues, which is whether the default position for an institution should be perpetual life. *See* Galle, *supra* note 51 (arguing against perpetuity for foundations).

[59] *See e.g.,* Harvey P. Dale, *The Buck Trust*, available at http://tinyurl.com/hkokcbd; DOUG WHITE, ABUSING DONOR INTENT: THE ROBERTSON FAMILY'S EPIC LAWSUIT AGAINST PRINCETON UNIVERSITY (2014).

[60] Simes, *supra* note 12, at 117.

[61] *Id.*

[62] *Id*. at 116.

that donor choices might be more private than public, Simes recommended a time limit of roughly thirty years on donor restrictions.

The presumption of public benefit is no stronger today. The border marking entry into the charitable sector likely has never been as porous.[63] The standard for qualifying organization status under section 501(c)(3) remains broad.[64] The ability of the IRS to police bad actors and impose standards is perhaps at its lowest level ever.[65] This is not to say that 501(c)(3) organizations do not serve a public good, but simply that the public standard of 501(c)(3) is diluted and open to private influence. In other words, the presumption of public benefit may not be strong enough to warrant the exceptions the law provides. This is especially true in the context of restricted giving, where a private preference of the donor further compromises public benefit.

Moreover, the bargain Simes spoke of – public benefit in exchange for perpetuity – places emphasis on law's role of encouraging donors to give to charity. In other words, the risk is that without the promise of dead hand control, donors would instead keep their property. As Professor Galle has noted, this supposition is subject to challenge.[66] Doubt about the incentive effect of allowing dead hand control over charitable transfers thus calls into question whether a bargain is even necessary. The law should not assume that restrictions are a meaningful incentive to give, any more than the law should presume the public benefit of a restricted gift. Ironically, current law could be critiqued as offering unnecessary incentives for uncertain benefit.

Indeed, in the aggregate, restricted gifts could come at a net cost. That is, many donors likely place restrictions on property simply because they are given the option. For such donors, without restricted giving, the donor would have made an unrestricted gift of

[63] Small organizations now can qualify for 501(c)(3) status by submitting to the IRS little more than a checklist, agreeing that organization has an exempt purpose and that it will not engage in prohibited activity. *See* Form 1023-EZ.
[64] *See generally* Rob Reich, Lacey Dorn, & Stephanie Sutton, *Anything Goes: Approval of Nonprofit Status by the IRS*, STAN. U. CENTER ON PHIL. AND CIVIL SOC. (Oct. 2009). Abuse aside, a broad standard is a trait of the charitable transfer system, allowing for pluralism and innovation.
[65] *See* excellent Chicago-Kent symposium (2016).
[66] *See* Galle, *supra* note 51, at 21 (finding that "several eminent commentators have observed [that] there is no empirical support for the proposition that restricted spending encourages donations") (citing Posner, others). By "restricted spending," Galle generally means the ability to delay spending to the future.

the same amount. Society then is worse off by allowing restricted gifts, reducing public benefit by the costs of the restriction.

In short, unrestricted gifts are better. Nonetheless, even though charities prefer unrestricted gifts and the efficiencies they bring, restricted giving has become a reflexive and established mode of giving. But there are costs to the historic bargain, costs that are not sufficiently taken into account by current law, and which should not be ignored because of a presumed, tenuous public benefit.

Part III. Using Tax Law to Discourage Restricted Gifts

As a general matter, donor influence over assets that are dedicated to public use represents a private not a public good, and should be resisted. Yet current law widely tolerates donor restrictions. Property law gives donors the power to impose restrictions, sets limits with rules against perpetuities and accumulations, then makes exceptions to the limits for charitable transfers on the theory that the public benefit outweighs any cost, and that donors need an incentive to give. Tax law further facilitates charitable transfers by providing charitable deductions in both the income and estate tax. Serving a dual role, however, tax law also works to prevent donor, or private influence over charitable transfers through the completed gift rule, the partial interest rule, rules against private benefit and inurement, and tighter regulation of private charities.[67] Given that unrestricted gifts are preferable, the law can and should directly discourage donor restrictions. The question is how, and which body of law to use.

A. *Property and Cy Pres Reform*

The place to start the inquiry is property law, as it provides the base power for donor restrictions. Going directly to the source, one option would be to eliminate the ability of grantors to impose restrictions on property, at least in the context of charitable transfers. But this is both unrealistic and undesirable – running contrary to centuries of law and

[67] The return benefit rule, is more a mechanical rule of measurement to assess the net gift than a private benefit rule, though both purposes are served.

practice. Besides, if donors and charities mutually agree to a restriction, absent a clear violation of public policy, there is no reason for private law not to honor the agreement, notwithstanding the unequal bargaining power of the parties.

Another option would be to apply the rules against perpetuities and accumulations to charitable transfers. On the face of it, the case for excepting charitable transfers from normally applicable property rules is weak. Why tolerate private perpetuities and accumulations in charitable use property? The whole point of charity law is to promote public ends. Private perpetuities, even though charitably inclined, bear the imprimatur of personal whimsy, which increases over time. Other parts of the law already work to ensure that once a charitable transfer is made the property (or its substitute) remains in a charitable use in perpetuity. Private perpetuities thus are not needed to preserve a public use, but only on the basis that donors require perpetuity as an incentive to give, which as noted in Part II, is a tenuous claim.

Even if a compelling case can be made to eliminate the property law exceptions for charitable transfers, doing so would at best be a partial remedy to the prevalence of restricted giving. For one thing, there is no federal law of property, meaning that fundamental changes to property law generally must occur organically, and on a state-by-state basis. For another, the trend in property law is to weaken or eliminate the rule against perpetuities not strengthen it,[68] so attempts to apply the rule in a context where historically it has not applied would be difficult.

Further, even if the rule against perpetuities applied to charitable transfers, it would be of limited effect. Roughly speaking, the RAP strikes down interests that vest in the vicinity of 90 years after the death of the grantor. Thus, the RAP would permit donors to dictate use for scores of years after a donation, thus fixing only the most egregious forms of dead hand control. In addition, the RAP would not apply to mere use restrictions that do not arise to the level of a formal property right, further limiting its impact.

[68] Indeed, this trend is one reason for revived interest in the rule against accumulations. *See* Sitkoff, *supra* note 8.

The next place to look for reform is charitable trust and corporate law, specifically with changes to the doctrine of *cy pres*. Lewis Simes, for instance, argued for a broader doctrine of *cy pres*, namely that courts should be more willing to permit loosening of donor intent.[69] Professor Rob Atkinson has argued convincingly for *cy pres* reform, or absent reform, for charities in effect to work around donor intent when expedient.[70] Professor Harvey Dale takes a middle ground, placing primacy on the gift agreement, and so donor intent to dictate terms, but with default rules that, absent something contrary in the gift agreement, give effect to a variance power adopted by the charity to alter donor instructions.[71] Other scholars have weighed in in the *cy pres* reform discussion, and over the years courts have indeed relaxed historic *cy pres* requirements.[72]

Cy pres reform unquestionably is important to the debate about weakening the pull of donor intent, but also of limited impact. Implicitly accepted within the terms of debate is that donors should not be discouraged per se from imposing restrictions on gifts; rather, donor restrictions should just be easier to remove. But if the goal is to reduce restricted giving, as this essay argues it should be, then legal reform should focus on limiting incentives to impose donor restrictions in the first place, obviating the need either for a rule against perpetuities or *cy pres*.[73] The federal tax law of charity, and specifically the rules of the charitable deduction, are a natural fit for reform of this type.

B. *Tax Law Reform*

In the co-dependent relationship between charity and donor, donors have the upper hand. The default rules of property law support donor restrictions, and when tax law treats restricted assets the same as unrestricted assets, the somewhat perverse result is to encourage restrictions, simply because they are not discouraged. Add to that the fact that

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[69] Simes and others have advocated for a time limit on future interests retained by the donor (possibilities of reverter and rights of entry), an approach taken by some States.
[70] Rob Atkinson, *Reforming Cy Pres Reform*, 44 HASTINGS L. J. 111 (1993); Rob Atkinson, *The Low Road to Cy Pres Reform: Principled Practice to Remove Dead Hand Control of Charitable Assets*, 58 CASE W. RES. L. REV. 97 (2007).
[71] *See* Harvey P. Dale, *Controlling Donor Intent*, in this volume.
[72] For a discussion of developments, *see* Marion R. Fremont-Smith, GOVERNING NONPROFIT ORGANIZATIONS: FEDERAL AND STATE LAW AND REGULATION 173-86 (2004).
[73] Limiting restricted giving does not address the spending policy of charities.

donors, especially the wealthiest, can create and control their own charities, or choose not to give, and it is no surprise that charities, in need of support, readily yield to donor restraints.

Yet when donors retain influence over charitable use assets, it is almost by definition a private benefit. By imposing a restriction, the donor tells the charity: "do it *my* way." In a sense, the charity becomes a rented vehicle for implementing private donor intent. The donor pays rent in the form of a donation – supported by the government – and in return uses the institutional apparatus of the charity to invest and ultimately spend the donated sums. In other words, where donor restrictions are involved, there is a fine line between private charity and private benefit.

At the heart of tax law is a tension between a donor's desire to impose restrictions and a charity's preference for independence. The modus operandi of the tax law of charity is to constrain private behavior as a way to promote charitable outcomes. But the failure to take account of donor restrictions lets donors take a deduction for a personal benefit, encourages a costly practice, and undermines the public interest. Given the tax law's role in encouraging transfers to charity, and in protecting the independence of charities, the law should put a thumb on the scales in favor of charity independence from donor restraints by directly discouraging restricted giving.

As discussed in Part I, a conceptual framework is already in place. The reform issues are how to characterize donor restrictions for tax purposes, and the result of the characterization. There are broadly two paths. Under one path, the "retained right" approach, donor restrictions could be viewed as partial interests or retained rights,[74] in violation of either the partial interest rule or the completed gift rule. The result would be no charitable deduction for restricted gifts. Under another path, the "substantial value" approach, donor restrictions could be viewed as significantly affecting the value of the contributed property, or as a return benefit. The result would be to reduce the amount of the deduction by the value of the restriction. Ultimately, deciding which approach is best may

[74] For simplicity here, partial interests and retained rights will be treated the same.

come down to determining the most appropriate disincentive for restricted gifts: complete or partial disallowance.

(i) *Retained right approach*. There are several arguments in support of a retained right characterization of donor restrictions. One involves donor standing. Historically, donors lacked standing to enforce a restriction, leaving it to the state attorney general to defend donor interests against a capricious charity, pursuant to *cy pres* doctrine. As Professor Dale explains, however, the modern trend is to provide for donor standing (especially in the trust context), thus allowing donors directly to enforce their restrictions.[75] If a donor has standing to prevent deviations from donor intent, it is a stronger case that a donor has retained a legal right as part of the charitable transfer so as to trigger the partial interest rule. A donor with standing to enforce her will on the charity effects the degree to which a charity has full dominion and control of the property, and suggests that a donor has not given up her entire interest.

In addition, a retained right characterization is consistent with the rationales for the partial interest rule, which include avoiding conflicts of interest and difficulty in valuation. When a donor does not give her entire interest, or places restrictions on use, there is a potential conflict of interest over use between the donor and the charity. The legions of cases involving charity-donor divergence over asset use attest to this conflict.[76] Further, as discussed below, valuation of restrictions is problematic. Donor restrictions, though of clear value to the donor, have no observable transactional value, making it hard to reduce the deduction accurately by the value of the interest retained.[77]

[75] See Dale, *supra* note 19 (noting also that donors may and do provide for standing in gift agreements); UNIFORM TRUST CODE § 405(c). Extension of standing rights is yet another way donor intent is a favorite of the law.
[76] *See e.g.,* Harvey P. Dale, *The Buck Trust*, available at http://tinyurl.com/hkokcbd; DOUG WHITE, ABUSING DONOR INTENT: THE ROBERTSON FAMILY'S EPIC LAWSUIT AGAINST PRINCETON UNIVERSITY (2014).
[77] Relatedly, some donor restrictions, especially those involving forfeiture, could be said to involve the "right to use property." A right to use property already is treated "as a contribution of less than the [donor's] entire interest," and no charitable deduction is allowed. I.R.C. § 170(f)(3)(A). As noted in Part I, the regulations permit a deduction when the donor retains a future interest (like a possibility of reverter) so long as the likelihood of forfeiture, determined on the date of gift, is "so remote as to be negligible." Treas. Reg. § 1.170A-7(a)(3).

Relatedly, a retained right characterization also fits generally within the rationale of the completed gift rule. As noted, the completed gift rule requires that formal ownership of the property be vested in a charity under a dominion and control standard. The rule helps to ensure that institutions, not donors, legally control donated assets.[78] As noted in Part I, however, the test is formalistic, geared to a charity's legal right of ownership, notwithstanding retained expectations of effective control by donors.[79] Nevertheless, taking a substance over form approach, when donors impose restrictions, charities do not have effective dominion and control of their property. A restriction to spend only income, for example, means that the donor has dictated the essential terms of holding the property, notwithstanding that the restriction does not affect ownership or alienability of the contributed property. Similarly, although a use restriction ("for use as a school") may not affect a charity's dominion and control of the property in a formal sense (though alienability clearly is affected), the restriction nevertheless affects control in very practical terms.

In short, plausible arguments can be made that donor restrictions, especially those that are enforceable by the donor, should be characterized as retained rights that amount either to a partial interest in property or in denying the charity sufficient dominion and control of the property for purposes of the charitable deduction. In either case, no deduction would be allowed.

(ii) *Substantial value approach*. An alternative characterization of donor restrictions is to focus on how restrictions affect the value of property contributed, and whether there is a return benefit. Under current law, if a restriction is substantial enough to affect the fair market value of the property (by comparing pre- and post-donation value), or could be viewed as a return benefit, then the amount of the deduction is reduced by the diminution in value.

The current law framework, as presently applied however, largely ignores most routine donor restrictions. For example, an "income-only" spending restriction generally is not viewed as affecting the fair market value of the property contributed. The present

[78] Were it otherwise, donors could take deductions without giving anything away.
[79] *See* Part I.C(ii) (noting that donor advised funds and private foundations are ways around the completed gift rule).

value of the contribution is the same regardless of whether the charity spends the gift when contributed, or later.[80] Similarly, a purpose limit also need not affect value, as the objective value of the gift as spent for a specified purpose generally is the same as it would be if spent for another purpose chosen by the charity.[81]

Further, donor restrictions typically are not viewed as a return benefit. As discussed in Part I, a restriction often is in the nature of something retained by the donor, not something provided by the charity in return for a donation. So although there is a benefit to the donor, it is not a return benefit as traditionally understood, e.g., in the nature of distinct goods or services.

Nevertheless, the fact that donor restrictions generally are disregarded is more a function of passive acceptance of the status quo than deliberate choice. There is little doubt but that donor-imposed restrictions benefit the donor and that donors value them. Otherwise, donors would not bother to impose restrictions. In addition, in some cases, the benefit to the donor is in the nature of a return benefit. For example, donors to donor advised funds of sponsoring organizations receive the privilege of providing advice. The advisory privilege is a benefit in return for the donation, albeit one that does not currently count under the return benefit rules.

Donor restrictions also indubitably affect the value of the property contributed to the charity. Charities may (in most cases) receive a fee simple, but a charity's use is circumscribed by the private choice of the donor.[82] Relatedly, as Part II explained, donor restrictions impose a variety of significant costs on charities, costs that charities tolerate because of the imbalance in the charity-donor relationship. These costs relate directly to the value of the property received, making restricted property less valuable than unrestricted property. In short, neither the value nor the cost of donor restrictions is de minimis. And

[80] Michael Klausner, *When Time Isn't Money*, STAN. SOCIAL INNOV. REV. (Spring 2003). Whether the charity *should* spend to meet current over future needs is a separate issue, apart from valuation.
[81] Comparing the value of two uses here is akin to comparing worthiness, which is not objective.
[82] Charities by definition face a general restraint of using assets for public purposes, which is of course entirely proper. The issue here is how much the law should encourage private donor preferences to control the public interest over time.

although donor restrictions may not have an objective measure of value, that is not a reason to ignore them.

The obvious difficulty is determining how to value donor restrictions in order reasonably to ascertain the amount of the deduction.[83] A subjective-based measure plainly would be inadministrable, whether from the donor's point of view,[84] or the charity's.[85] With no ready objective measure,[86] a straightforward approach would simply be to subtract a percentage of the fair market value of the contributed property, as determined under the usual willing buyer-willing seller standard. For example, if the percentage was ten, the amount allowed as a deduction for the gift of an endowed fund of $1 million would be $900,000. The percentage discount would represent the value of the restriction.

(iii) *Impact*. In summary to this point, there are reasonable arguments, consistent with present law concepts, in favor of either the retained right or substantial value approach to donor restrictions. That said, either approach may seem a radical departure from present law by discouraging what is now routine. Given the arguments in favor of discouraging restricted gifts, the reasons not to act would be because of the age-old concern that donors that most value donor restrictions would not give without a tax incentive, or would give less; and perhaps because of adverse changes to giving culture. The question then is how donors and charities would respond.

On the concern that donors would not give, it is important to keep in mind that under either reform approach, donor restrictions would continue to be allowed consistent with property law. The change would be to the tax incentive, not to the ability to make restricted gifts. Thus, donors who are attracted by restricted giving would face essentially three options: make a restricted gift but receive no (or a reduced) tax benefit for the gift, make an unrestricted gift with full tax benefits, or keep their money concluding in effect that the only gift worth making is a restricted gift with full tax benefits.

[83] As noted above, the valuation problem is an argument for complete disallowance.
[84] The value would be highly variable from donor to donor and restriction to restriction and unenforceable.
[85] Focusing on the value to the charity arguably would be a more objective approach than focusing on the value to the donor. The value calculation would be fair market value discounted by the costs borne by the charity.
[86] *But see* Galle, *supra* note 51.

Of the three options, the decision not to give seems the least likely. Donors give to charity for many reasons – the desire to help others being a leading motivation. Many donors place restrictions on gifts because of current giving culture, not out of an innate desire to impose restrictions. A tax law change to discourage restricted giving thus would alter giving culture in a positive way, nudging many if not most donors away from restricted gifts. For these donors, the desire to give to charity, plus the present law tax incentive for unrestricted gifts, would prevail. The result would be a net benefit to charity and to the public interest from more unrestricted giving, without much if any reduction in nominal giving amounts.

For some donors a prime reason to give is to establish a legacy. For these donors, often the wealthiest, restricted giving has the most appeal. Typical legacy gifts might be to fund a private foundation or a multi-million dollar endowment to a university. Thus, if large legacy gifts are tax disfavored, there is a risk that donors would not make them. The risk, however, appears low. The largest charitable gifts, whether to a public charity or private foundation, paradoxically are the gifts where tax incentives matter the least. Present law limits the charitable deduction to a percentage of income over a five-year period, which means that for many wealthy donors, the tax benefits pale in comparison to the size of the gift. For these donors then, limiting the incentive for restricted giving likely would not deter giving, which is driven by reasons other than tax incentives.[87] But it would limit the cost to the public of gifts that bear restrictions yet would still be made.

Nevertheless, another argument against disfavoring restricted giving might be that the charity-donor relationship would be undermined. Some might argue that the culture of restricted giving fosters closer donor-charity relationships, positively involving donors in charitable activities and in the community. Disfavoring restricted giving, however, need not have any adverse impact on donor-charity relations. Charities could continue to encourage donor involvement in a variety of ways; the only change would be that donor involvement would more often fall short of imposing restrictions on gifts. Donors forgoing

[87] A recent case in point was the Chan-Zuckerberg Initiative. In the foundation context, donors exercise control not through restrictions on gifts but by controlling the charity. This is where reform proposals relating to payouts at private foundations become relevant.

restrictions might even become more involved. Restrictions are passive dictats, which if utilized less, could lead donors to be more active in positive ways to help a charity steward donated funds.

In the margin, the most significant aspect of reforming restricted giving could well be to encourage a modest shift away from restrictions and toward a more informal relationship between charity and donor. Donors would continue to have clear ideas about how money should be spent, and charities may be in full agreement with a donor's wishes, but would have more leverage. If the tax benefits are important to secure the gift, charities and donors might respond by crafting a formally unrestricted gift, with an informal understanding that the charity would be honor if not duty bound to be guided by a donor's preference. The charity though could at any time take a different approach. Over time, only those donors who remain active with a charity, and so show continued interest, are likely to have continued influence. Informal agreements with other donors would fade along with the donor-charity relationship, which is as it should be. The dead (or living) hand would retreat with the passage of time, and interest. Charities would not be burdened by stagnant preferences.

There remains a choice between the retained right and substantial value approach. The retained right approach and the resulting disallowance of the charitable deduction for restricted giving would send the strongest signal that restricted gifts are disfavored, and so have the brightest impact on shifting giving culture away from restricted gifts. The main reason to opt for a substantial value approach would be to the extent there was serious concern that disallowance would result in a net cost to charity, which as argued above, is not warranted. The retained right approach also would be easier to administer. There would be no need to calculate the disallowance, which in the case of noncash property contributions, could give rise to valuation disputes.

Inevitably, there are important questions about how to define restricted giving. Restrictions relating to the timing of expenditure (e.g., endowed funds) and to the use of donated assets would count. The definition of a "material restriction" in the Treasury Regulations could also provide a basis for bringing in certain types of restrictions, mainly in the community foundation and donor advised fund context.[88] That said, a substantial value approach might be suitable for restrictions that are best styled as return benefits not retained rights, institutionalized advisory privileges being foremost among them.

Conclusion

Unrestricted giving is better giving. The ability of donors to place restrictions on gifts is a venerable vestige of property law, tolerated largely as part of a historic bargain. When Lewis Simes famously lectured about allowing exceptions to the rules against perpetuities and accumulations for charitable transfers, he acknowledged the reasoning and its tenuous basis: that honoring donor restrictions would encourage donors to part with property for the public interest. Simes though did not consider the role that tax law plays further to encourage charitable transfers. However, two sets of incentives for restricted gifts are not needed. The role of tax law should be to foster good giving practices and to discourage private influence over the charitable sphere. Disfavoring restricted gifts relative to unrestricted gifts is both a matter of common sense and good public policy, would improve giving culture without harming the bottom line for charities, and fits within existing tax law concepts. The tax law should be reformed accordingly.

[88] Treas. Reg. § 1.170A-9(f)(10). Under the regulations, advisory privileges would count as restricted giving and so no deduction would be allowed for most donor advised fund contributions if the material restriction regulations were used to define restriction. As the author has argued elsewhere, some policy response to donor advised funds is warranted, though under the circumstances, other options are more attractive than disallowance. *See* Roger Colinvaux, *Donor Advised Funds: Charitable Spending Vehicles for 21st Century Philanthropy*, 92 WASH. L. REV. __ (forthcoming 2017), available at http://papers.ssrn.com/sol3/papers.cfm?abstract_id=2677297.