

**The Role of Redistribution to the Poor
in Federal Tax Exemption for Charities***

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In an opinion piece published by the L.A. Times in October, 2007, Robert B. Reich opined that tax law should differentially treat contributions to a charity based upon whether the charity's purpose was to help the poor. "If the donation goes to an institution or agency set up to help the poor, the donor gets a full deduction. If the donation goes somewhere else – to an art palace, a university, a symphony or any other nonprofit – the donor gets to deduct only half of the contribution."¹ Sarah Waldeck similarly has suggested that Congress alter the rules for deductibility of donations to universities with "mega-endowments" to discourage gifts for buildings and encourage gifts for current spending,² and in a paper delivered to the Law and Society Conference in May, Evelyn Lewis suggested that tax benefits should be scaled back for charities which surpassed a certain level of wealth.³ Senator Chuck Grassley, the ranking minority member of the Senate Finance Committee, has also criticized large university endowments. In 2007, Grassley floated a proposal that universities with endowments of more than \$500 million be required to spend at least 5% of the endowment value annually,⁴ a rule similar to the distribution requirement for private foundations,⁵ and he has continued to criticize

¹ Robert B. Reich, *Is Harvard a Charity?*, Los Angeles Times, Oct. 1, 2007, available at <http://articles.latimes.com/2007/oct/01/news/oe-reich1>.

² Sara E. Waldeck, *The Coming Showdown Over University Endowments: Enlisting the Donors*, 77 FORDHAM L. REV. 1795 (2009).

³ Evelyn Alcia Lewis, *Consideration of a "Waste Not, Want Not" Tax Exemption Standard for Charitable Organizations* (paper delivered at the 2009 Law and Society Association Annual Meeting, May 30, 2009).

⁴ See, e.g., Karen W. Arenson, *Senate Looking at Endowments as Tuition Rises*, N.Y. Times, Jan. 25, 2008, available at <http://www.nytimes.com/2008/01/25/education/25endowments.html>; Thomas Kaplan, *Senator proposes mandating greater use of endowment*, Yale Daily News, October 19, 2007, available at <http://www.yaledailynews.com/articles/view/21942>. Grassley and Max Baucus, Chair of the Senate Finance Committee, followed up with a letter to 136 colleges and universities asking them about endowment and tuition policies. A copy of the letter is available at <http://www.nacua.org/documents/BaucusGrassleyLetterReEndowments.pdf>.

⁵ I.R.C. Section 4942.

universities “hoarding” endowments while raising tuition each year.⁶ Even England has gotten into the act: a recent article in *The Guardian* details how the Charity Commission has told private schools that they must provide significant access to their services to those that cannot afford the fees or lose charitable status.⁷

This is hardly the first time an observer has suggested that tax law ought to distinguish among various charitable activities.⁸ Indeed, tax law already does distinguish among charitable organizations on a number of fronts. Perhaps the most visible of these distinctions is that between public charities and private foundations, a distinction borne of concerns over accountability and taxpayer abuse of the foundation form.⁹ Many of the policy proposals that have been floated recently, however, either explicitly or implicitly tie tax benefits to a specific view of charity as being primarily concerned with helping the poor – or in other words, a conception of charity as a tool for wealth redistribution.

This paper reviews and comments on three areas of existing federal exemption law where the redistribution view either already controls tax benefits or is being pushed by policy makers as a change to existing law: the push for a charity care standard for

⁶ See, e.g., *Grassley: College Endowment Volatility is Not Excuse for Skirting Student Affordability*, available at http://grassley.senate.gov/news/Article.cfm?customel_dataPageID_1502=18959

⁷ Polly Curtis and Owen Bowcott, *Offer free places or lose charity status, private schools told*, *The Guardian*, July 14, 2009, available at <http://www.guardian.co.uk/education/2009/jul/14/charity-status-private-schools>.

⁸ In fact, back in the early 1990’s when Mark Hall and I proposed tying exempt status to the amount of donations an organization received annually, we suggested that the required amount of donations could vary from as much as one-third of annual operating income to as little as 10%, based upon factors such as whether the organization’s purpose was one historically recognized as charitable. JOHN D. COLOMBO AND MARK A. HALL, *THE CHARITABLE TAX EXEMPTION 196-224* (1995).

⁹ See, e.g., JAMES J. FISHMAN AND STEPHEN SCHWARZ, *NONPROFIT ORGANIZATIONS 760-762* (3d ed. 2006). While private foundations are exempt charities under I.R.C. Section 501(c)(3), they are subject to numerous regulatory provisions that “public charities” (not a defined term in the Code, but the common phrase used to identify charities that are not classified as private foundations per Code Section 509) are not. Private foundations, for example, generally are subject to a requirement that they make charitable grants each year equal to 5% of their asset value, I.R.C. Section 4942; face a 2% tax on net investment income under I.R.C. Section 4940; are absolutely prohibited from engaging in certain transactions (labeled “self-dealing”) with foundation managers or significant donors per I.R.C. Section 4941; and have limitations on the kinds of investments they can make (for example, they cannot own more than 20% of the voting interests in a corporation or partnership) under I.R.C. Sections 4943 and 4944; and are completely prohibited from making certain expenditures (such as lobbying) under I.R.C. Section 4945. In addition, charitable contributions to private foundation face more onerous restrictions under I.R.C. Section 170 than contributions to public charities. For a detailed discussion of these provisions, see *id.* at 832-866. See also FRANCIS R. HILL AND DOUGLAS M. MANCINO, *TAXATION OF EXEMPT ORGANIZATIONS*, Chapter 8 (2009).

exempting nonprofit hospitals, the current university endowment debate, and a hodge-podge of rulings relating to what I will call “middle class charity” in which the IRS has denied exemption to nonprofit organizations providing services to the middle class (as opposed to the poor). Part I provides a brief introduction to the history of the redistribution concept in federal exemption under 501(c)(3) prior to the current regulations introduced in 1959. Part II then provides a summary of current law and proposals in the three areas described above (nonprofit hospitals, programs aimed at the middle class, and university endowments). Part III then turns to some analysis and observations. The main observations are (1) that the redistributive push in the areas identified by this paper is almost certainly bad policy and inconsistent with the IRS’s supposed adoption of the broad common-law view of charity in the 1959 regulations; (2) that the redistributive paradigm seems to pop up most in areas where the organizations in question carry on activities that look very similar to commercial enterprises – in other words, what we may be seeing is the use of the redistribution paradigm to help distinguish charitable services from ordinary for-profit business; (3) limiting the definition of charitable for tax exemption purposes to relief of the poor is inconsistent with the historical definition of charity; and (4) the effort to limit the scope of tax exemption/deductibility to redistribution to the poor is inconsistent with virtually all the theories proposed to explain tax exemption and essentially adopts one particular view of distributive justice that may not be appropriate in formulating tax benefits for charities. Until tax policy chooses an underlying rationale for charitable tax exemption, however, the inconsistencies in applying exemption are likely to continue.

I. History: The IRS Redistributive View of Charity Prior to 1959

Though it may seem hard to believe from the vantage point of the early 21st century, at one time the IRS seemed to view relief of the poor as the only rationale for exemption for organizations that fell outside those specifically enumerated (e.g., religious and educational) in what is now Code Section 501(c)(3). In 1923, the IRS ruled that a civic association whose purpose was to promote “a higher civic and social life” through camps, clubs and classes was not exempt because the word “charitable” as used in the

existing exemption provision was limited to “relief of the poor” and not the broader charitable trust definition which encompassed virtually any benefit to a broad charitable class.¹⁰ Though the Service recognized the broader meaning of “charitable” in the common law, it concluded that because Congress specifically listed certain charitable organizations (e.g., religious, educational) that would have been included in a broad reading of the word “charitable,” Congress must have meant to limit “charitable” in the statute to its more “common” meaning of relief of the poor. Regulations from 1943 issued under the 1939 Code reaffirmed the view that “charitable” in the exemption statute was limited to relief of the poor: “Corporations organized and operated exclusively for charitable purposes comprise, in general, organizations for the relief of the poor.”¹¹ Even as late as 1956, a proposed regulation under the then-new 1954 Code’s section 501(c)(3) would have retained the view that “charitable” was limited to relief of the poor.¹²

It was not until 1959 that the IRS officially reversed course and adopted new regulations under 501(c)(3) that embraced the broad common-law view of charity. In this new regulation, the IRS stated that “charitable” in the statute was used in its “generally accepted legal sense,” and included:

Relief of the poor and distressed or of the underprivileged; advancement of religion; advancement of education or science; erection or maintenance of public buildings, monuments, or works; lessening of 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

¹⁰ I.T. 1800, II-2 Cum. Bull. 152 (1923). Historically, relief of the poor has been viewed as a charitable purpose at least since the Elizabethan Statute of Charitable Uses enacted by the English Parliament in 1601. The preamble to that statute, which is generally viewed as the “headwaters” of charitable trust law, listed “relief of aged, impotent and poor people” as an appropriate charitable purpose. See JOHN D. COLOMBO AND MARK A. HALL, *THE CHARITABLE TAX EXEMPTION* 34 (1995); James J. Fishman, *The Political Use of Private Benevolence: The Statute of Charitable Uses*, available at <http://digitalcommons.pace.edu/lawfaculty/487>. The official citation for the Elizabethan Statute of Charitable Uses is *An Act to Redress the Mis-Employment of Lands, Goods and Stock of Money Heretofore Given to Certain Charitable Uses*, 1601, 43 Eliz., ch. 4, reprinted in 7 STAT. AT LARGE 43 (Eng. 1763). The preamble, however, also listed a number of other public purposes that were considered charitable that were not directly connected to poor relief; see text and notes at notes 101-102_, *infra*.

¹¹ Treas. Reg. 111, §29.101(6)-1(a)(1943).

¹² Prop. Treas. Reg. 1.501(c)(3)-1(b), 21 Fed. Reg. 460, 463.

defend human and civil rights secured by law; or (iv) to combat community deterioration and juvenile delinquency.¹³

As the material below indicates, however, relief of the poor is still used in many contexts as the main indicator of charitable purpose, and has become a tax policy rallying point with respect to nonprofit hospitals and university endowments.

II. Examples of Redistributive Requirements/Proposals in Current Federal Exemption Law

A. Nonprofit Hospitals: the Rise, Fall and Rise of Charity Care¹⁴

Prior to 1969, federal income tax exemption for hospitals (and presumably other health care providers) essentially was tied to the concept of income redistribution to the poor, otherwise known in the hospital world as charity care. The official ruling position of the Service was set forth in Rev. Rul. 56-185, which required a hospital seeking exemption under Code Section 501(c)(3) to be “operated to the extent of its financial ability for those not able to pay for the services rendered.”¹⁵ While the Service never took an official position regarding how much charity care was “enough” or even how to define charity care for these purposes, if a hospital lacked a substantial charity care program, auditing agents almost always recommended denial or revocation of exempt status.¹⁶ This charity care standard reflected the pre-1959 view of the IRS discussed above that an

¹³ Treas. Reg. 1.501(c)(3)-1(d)(2).

¹⁴ Much of the discussion in this section is adapted or copied from John D. Colombo, *The Failure of Community Benefit*, 15 HEALTH MATRIX 29 (2005).

¹⁵ Rev. Rul. 56-185, 1956-1 C.B. 202, 203.

¹⁶ While the ruling recognized that this test would be applied on all the facts and circumstances (and that a low charity care record would not necessarily bar exemption), IRS auditing agents often denied or revoked exempt status if a hospital’s charity care was less than 5% of gross revenues. Robert S. Bromberg, *Charity and Change: Current Problems of Tax Exempt Health and Welfare Organizations in Perspective*, in TAX PROBLEMS OF NONPROFIT ORGANIZATIONS 149, 256 (1970); see *Hospital Charity Care and Tax-Exempt Status 1990: Restoring the Commitment and Fairness, Hearings Before the U.S. House of Representatives, Select Committee on Aging*, 102d Cong., 1st Sess. 58 (1990) (Statement of James J. McGovern, IRS Assistant Chief Counsel).

organization not within one of the specified exemption categories in 501(c)(3) and its predecessors had to be engaged in “relief of the poor” to be charitable.¹⁷

Concurrent with Congressional consideration of the Medicare and Medicaid legislation in the mid-1960’s, however, nonprofit hospitals began pushing the IRS for reconsideration of exemption standards on the grounds that between private medical insurance and the “new” Medicare and Medicaid programs, there simply would not be enough of a demand for charity care to satisfy the IRS, and hence exemption standards should become more flexible in order to maintain exempt status for hospitals.¹⁸ The 1959 version of the IRS regulations, moreover, appeared to accommodate a broader view of charity, more in line with the common law of charitable trusts.¹⁹ Accordingly, a young staff attorney with the IRS, Robert Bromberg began work on a new exemption standard.²⁰

This new standard appeared in Rev. Rul. 69-545,²¹ which quickly became known as the “community benefit” standard. This ruling abandoned charity care as the touchstone of exemption. Instead, citing the law of charitable trusts, the IRS held that the “promotion of health” for the general benefit of the community was itself a charitable purpose, even though some portion of the community, such as indigent patients, were excluded.²² Factors that indicated that a hospital met the community benefit test included a community board, an open medical staff, treatment of Medicare and Medicaid patients, and operation of an emergency room that provided emergency treatment to charity patients.²³ Charity care other than emergency treatment, however, was not required, and

¹⁷ See text and notes at notes 10-12, *supra*.

¹⁸ See Daniel M. Fox & Daniel C. Schaffer, *Tax Administration as Health Policy: Hospitals, The Internal Revenue Service & the Courts*, 16 J. Health Pol., Pol’y & Law 251, 269-70 (1991).

¹⁹ Treas. Reg. 1.501(c)(3)-1(d)(2). See text at note 13, *supra*, for the text of this regulation.

²⁰ See Fox & Schaffer, *supra* note 18, at *id*.

²¹ 1969-2 C.B. 117. For more general discussions of Rev. Rul. 69-545, see DOUGLAS M. MANCINO, TAXATION OF HOSPITALS AND HEALTH CARE ORGANIZATIONS § 4.03[1], 4.03[2][b] (Lexis 2001); THOMAS K. HYATT & BRUCE R. HOPKINS, THE LAW OF TAX-EXEMPT HEALTHCARE ORGANIZATIONS 130-132 (2d ed. 2001).

²² 1969-2 C.B. 117, 118.

²³ *Id*.

in a 1983 ruling, the IRS held that even hospitals without emergency facilities could qualify for exemption under the community benefit approach.²⁴

Despite the official abandonment of charity care as a requirement of exemption in Rev. Rul. 59-545, the IRS soon began to express its discomfort with the broad implications of the community benefit standard, particularly when dealing with health care providers outside the mold of the traditional community acute-care hospital. In *Sound Health Association*,²⁵ decided by the Tax Court in 1978, the IRS challenged 501(c)(3) exemption for a “staff model” health maintenance organization (HMO)²⁶ that accepted all paying patients, operated an open emergency room and had a board of directors drawn from the general community. Though the IRS argued that Sound Health should be denied exemption because it primarily served the private interests of its members, rather than the general community, the Tax Court held that in practice, Sound Health’s membership was unlimited, and therefore it “promoted health” for the general benefit of the community much as the exempt hospital in Rev. Rul. 69-545 did. Sound Health, however, marked the beginning of IRS assertions that, notwithstanding the language in Rev. Rul. 69-545, simply providing health care to a broad cross-section of the community was insufficient to warrant exemption.

²⁴ Rev. Rul. 83-157, 1983-2 C.B. 94. This ruling noted that specialty hospitals, such as cancer treatment hospitals, generally could qualify for exemption under the community benefit approach even though they did not operate emergency facilities.

²⁵ *Sound Health Ass’n v. Comm’r*, 71 T.C. 158 (1978).

²⁶ While there are many different permutations of the relationship between an HMO and the doctors that provide services to the HMO subscribers, one can break HMO’s into two general categories: “staff model” HMO’s where doctors are employees of the HMO, and “contract model” HMO’s where the HMO contracts for services with individual doctors or groups of doctors. The contract model has several different variations, depending on how the contract between the HMO and doctors is executed. *See generally*, BARRY R. FURROW, ET. AL., *HEALTH LAW* 54 (2d ed. 2000).

Some may wonder why the enactment in 1986 of Section 501(m) of the Code, prohibiting exemption for “commercial-type insurance,” did not definitively end the exemption debate with respect to HMO’s. The answer is that initially the IRS did appear to view 501(m) as applicable to HMO’s (and instructed agents to that effect in the Internal Revenue Service Manual), but then reconsidered its position in light of extensive legislative history that strongly suggested the legislation was intended only to reverse the tax status of exempt Blue Cross/Blue Shield plans and was not intended to affect the tax status of HMO’s. In Notice 2003-31, the IRS announced that it would embark on a regulations project to defined the scope of 501(m) and was withdrawing the sections of the IRM that instructed agents to apply 501(m) to HMO’s. The regulations have never been finalized. For an extensive discussion of the history of 501(m) and the legal arguments surrounding whether it should apply to HMO’s, see MANCINO, *supra* note 21, at Section 6.03.

In the late 1980's, the IRS's pullback from the broad language in Rev. Rul. 69-545 became more pronounced as the agency began to emphasize lack of charity care in its health care exemption challenges. Once again, an HMO case served as the backdrop, as the IRS denied 501(c)(3) exemption to Geisinger Health Plan, a separate corporate subsidiary of a large integrated health care network formed to expand medical services to underserved areas in rural northeastern and north-central Pennsylvania.²⁷ As with the HMO in Sound Health, the Geisinger HMO offered membership to virtually anyone in the Geisinger service area.²⁸ Unlike Sound Health, however, Geisinger was a "contract model" HMO, offering services via contracts with area doctors and other entities in the Geisinger health system, rather than employing doctors and operating health facilities directly (the "staff" model employed by Sound Health).²⁹ In addition, Geisinger had virtually no charity care program: though it had formally adopted a subsidized dues program for indigents, at the time of its exemption application it had not implemented that plan due to financial constraints, and the plan itself was quite modest, projecting a maximum of 35 indigent enrollees during the first 3 years of operation.³⁰ The IRS used these two main differences, along with the fact that Geisinger did not yet have an approved Medicaid provider plan in place (though it did enroll Medicare patients) to support its denial of exemption.

The Tax Court, however, rejected the IRS arguments that Geisinger failed to meet the standards of Rev. Rul. 69-545, noting that as with Sound Health, Geisinger's members of some 70,000 persons in its service area was "practically unlimited" and that accordingly the HMO provided the same community benefit required by Rev. Rul. 69-545 as Sound

²⁷ The Geisinger Health System at the time of the litigation was a conglomerate of related organizations that included the Geisinger Foundation, Inc. (the parent corporation), two large regional acute care hospitals recognized as exempt under IRC § 501(c)(3); a medical group practice clinic; an alcohol detox center; two professional liability trusts and a management services entity. *Geisinger Health Plan v. Commissioner*, 60 T.C.M. (P-H) 3209, 3210 (1991), *rev'd* 985 F.2d 1210 (3d Cir. 1993).

²⁸ The only membership requirements were that an individual be at least 18 years old, reside in the Geisinger service area, and fill out a medical history questionnaire. *Id.* at 3213.

²⁹ *Id.* at 3212.

³⁰ *Id.* at 3212-14, 3217.

Health by promoting health care for a broad cross-section of the community.³¹ In short, the Tax Court continued to apply the “community benefit” standard articulated in Rev. Rul. 69-545 in its broadest sense, despite IRS arguments focusing on the lack of charity care and the method of delivery of services (contract model vs. staff model).

On appeal, however, the Third Circuit reversed. The court found that the Tax Court had too liberally applied the community benefit standard, and bought the IRS arguments that Geisinger’s lack of charity care, as-yet unrealized treatment of Medicaid patients and use of the contract model meant that Geisinger was “primarily benefitting itself” rather than the general community.³² This reversal by the Third Circuit was especially significant in that the court refused to accept the Tax Court’s view that “promotion of health” for the general community essentially meant delivery of medical services to a broad cross-section of the population. Instead, the Third Circuit appeared to want evidence of something more than simply the providing of medical services to paying patients, and one of the key aspects of “more” was a substantial charity care program.

More evidence of the IRS’s return to a charity care emphasis in health care exemption cases came as a result of the accelerating trend for vertical integration in health care delivery in the late 1980’s and early 1990’s. In a series of rulings dealing with integrated delivery systems (IDS’s), the IRS considered how to apply the community benefit standard to the parent corporation of these integrated providers.³³ In each case, it was clear that the organization in question met the general requirements of Rev. Rul. 69-

³¹ *Id.* at 3217.

³² *Geisinger Health Plan v. Comm’r*, 985 F.2d 1210, 1219-20 (3d Cir. 1993).

³³ In general, an IDS consisted of a parent corporation and several corporate subsidiaries. In general, these integrated systems directly operated acute-care hospitals, outpatient clinics, and specialty health services such as psychiatric clinics, and either employed staff physicians on salary or contracted with a physician group practice to provide services and paid them on a capitated basis. The first highly-publicized ruling on an IDS involved the Friendly Hills Healthcare Network, and was released by the Service on January 29, 1993. *Letter from Marvin Friedlander, Chief, Exempt Organizations Rulings Branch 1, to Peter N. Grant, Friendly Hills Network*, reprinted in 7 EXEMPT ORG. TAX REV. 490 (1993). The Friendly Hills ruling was followed by a ruling on exemption for Facey Medical Foundation, *Letter from Jeanne S. Gesspy, chief, Exempt Organizations Rulings Branch 2, to Don Abramsky, Facey Medical Foundation*, reprinted in 7 EXEMPT ORG. TAX REV. 828 (1993). The third major ruling, involving Harriman Jones Medical Foundation, followed a few months later. *Harriman Jones Exemption Ruling*, reprinted in 9 EXEMPT ORG. TAX REV. 719 (1994). For more extensive discussions of the facts of these rulings, see MANCINO, *supra* note 21, at § 8.03.

545 by having a community board, operating acute-care facilities with an open emergency room, and participating in Medicare/Medicaid reimbursement programs.³⁴ Yet in each ruling, the IRS stressed the organization’s commitment to charity care as a significant factor in granting exemption³⁵ – and even IRS officials and administrative audit guidelines issued during this period admitted that charity care had become a major part of exemption analysis for integrated providers.³⁶ The IRS sounded this same theme a few years later in its famous public ruling on joint ventures between hospitals and for-profit health care organizations, Revenue Ruling 98-15, where the IRS noted that denying services to indigents would tend to negate charitable status.³⁷ Thus in all these rulings, the IRS followed a consistent analysis: the mere fact that these entities clearly were providing health care services to a broad cross-section of paying patients (including participation in Medicaid programs) was insufficient to support exempt status; more (and the most-cited “more” was some significant charity care commitment) was required.

The not-so-slow transition of the community benefit standard from “health care for the general benefit of the community” to “health care for the general benefit of the community plus something else, preferably significant charity care” became complete at the turn of the century with a series of cases dealing once again with the exempt status of HMO’s. The cases involved three subsidiary corporations in the Intermountain Health Care system, each of which had been formed to conduct an HMO business in IHC’s service area.³⁸ While each of these cases also dealt with whether the HMO subsidiaries

³⁴ *Id.*

³⁵ The Friendly Hills ruling noted that Friendly Hills had agreed to provide free or discounted follow-up care to any charity patient admitted for emergency treatment; in the Facey and Harriman Jones rulings, the IRS committed to a specific level of charity care per year for a set time period (\$400,000 in Facey; \$750,000 in Harriman Jones). See MANCINO, *supra* note 21 at *id.*. Each ruling also discussed other “plus” factors such as health education and medical research programs. *Id.*

³⁶ See Charles F. Kaiser & John F. Reilly, *Integrated Delivery Systems*, in EXEMPT ORGANIZATIONS CONTINUING PROFESSIONAL EDUCATION TECHNICAL INSTRUCTION PROGRAM TEXTBOOK 212, 224-25 (Internal Revenue Service 1993); *Transcript of Spring ABA EO Committee Meeting*, 8 Exempt Org. Tax Rev. 89, 91 (comments by Marc Owens).

³⁷ 1998-1 C.B. 718, 720 (quoting language from *Sonora Community Hospital v. Commissioner*, 46 T.C. 519, 525-26 that “something more is required for exemption than diagnosis and cure of disease . . .”).

³⁸ The cases were *IHC Care v. Commissioner*, 82 T.C.M. 617 (CCH), 2001 Tax Ct. Memo LEXIS 282 (2001); *IHC Group, Inc. v. Commissioner*, 82 T.C.M. 606 (CCH), 2001 Tax Ct. Memo LEXIS 283 (2001)

could claim derivative exemption based on being an “integral part” of the larger IHC health care enterprise, the Tax Court addressed arguments that the HMOs were exempt in their own right. In dismissing these arguments (and holding against a grant of exemption), the Tax Court in the IHC Health Plans case specifically highlighted the lack of a significant charity care component of the HMOs’ operations:

Despite petitioner’s open enrollment policy and the wide acceptance of its plans by individuals and groups alike, petitioner’s operations differed materially from the operations of Sound Health Association HMO and Geisinger HMO. Significantly, petitioner did not own or operate its own medical facilities, did not employ (to any significant extent) its own physicians, and did not offer free medical care to the needy. Additionally, petitioner did not institute any program whereby individuals were permitted to become members while paying reduced premiums, and, aside from the few free health screenings that petitioner conducted in 1999, petitioner did not provide or arrange to provide any free or low cost health care services. The record does not reflect whether petitioner applied surplus funds to improve facilities, equipment, patient care, or to enhance medical training, education, and research. See Rev. Rul. 83- 157, 1983-2 C.B. 94.³⁹

In the companion IHC Care decision, the language was similar:

Against this backdrop, we further note that, unlike the HMO in *Sound Health Association v. Commissioner*, supra, petitioner did not own or operate its own medical facilities, nor did petitioner employ its own physicians. Consequently, petitioner could not provide free medical care to those otherwise unable to pay for medical services. Additionally, petitioner did not establish a subsidized premiums program, conduct research, or offer free education programs to the public. Petitioner’s Core Wellness Program was offered exclusively to its enrollees.⁴⁰

These cases were a watershed of sorts, because they represented the first time that the Tax Court agreed with the IRS position that simply providing health services for pay to the general community was insufficient to support exemption; rather some “plus,” such as charity care, education or research programs, was required. Moreover, this “promotion of health plus” standard was embraced on appeal by the 10th Circuit.⁴¹ In its discussion of

and *IHC Health Plans, Inc. v. Commissioner*, 82 T.C.M. (CCH) 593, 2001 Tax Ct. Memo LEXIS 284 (2001).

³⁹ 2001 Tax Ct. Memo LEXIS 284 at *48-*49 (emphasis added).

⁴⁰ 2001 Tax Ct. Memo LEXIS 282 at *34-*35 (emphasis added).

⁴¹ *IHC Health Plans, Inc. v. Comm’r*, 325 F.3d 1188 (10th Cir. 2003).

the community benefit test, the court stated plainly that “an organization cannot satisfy the community benefit requirement based solely on the fact that it offers health-care services to all in the community in exchange for a fee. . . . Rather, the organization must provide some additional ‘plus.’”⁴² First on the list of these “pluses” was “free or below-cost services,” though the court acknowledged that “devoting surpluses to research, education and medical training” might also suffice, and that treatment of Medicare/Medicaid patients was a virtual requirement.⁴³

Despite the 10th Circuit’s suggestion that something other than charity care could satisfy the community benefit requirements, one suspects that in cases other than community-based acute-care hospitals, significant charity care will be required for exemption. Indeed, in its 2002 textbook advising field agents on issues relating to tax exemption, the two examples the IRS gave of health care organizations other than acute-care hospitals that qualified for exemption were an organization that provided free medical screening to uninsured inner-city residents and an organization that provided free dental care to children from low-income families.⁴⁴

The return of charity care as a sine-qua-non of exemption for health care providers continues today at both the federal administrative and legislative levels. On the administrative front, the new Schedule H to Form 990 clearly emphasizes the role of charity care in defining “community benefit.” For example, Part I of the schedule is titled “Charity Care and Certain Other Community Benefits,” and the first six questions deal with hospitals’ charity care policies.⁴⁵ The instructions to the new form similarly emphasize charity care’s prominent role in the community benefit standard.⁴⁶

⁴² *Id.* at 1197.

⁴³ *Id.* at 1197-98 (“[T]he primary way in which health-care providers advance government-funded endeavors is the servicing of the Medicaid and Medicare populations.”).

⁴⁴ Lawrence M. Brauer, et. al., *Update on Health Care*, in EXEMPT ORGANIZATIONS CONTINUING PROFESSIONAL EDUCATION (CPE) TECHNICAL INSTRUCTION PROGRAM FOR FISCAL YEAR 2002 173-74 (IRS 2001).

⁴⁵ IRS Schedule H, Part I, available at <http://www.irs.gov/pub/irs-pdf/f990sh.pdf>.

⁴⁶ IRS Instructions for Schedule H at 2-3, available at <http://www.irs.gov/pub/irs-pdf/i990sh.pdf>.

On the federal legislative side, Senator Chuck Grassley (IA) has led the recent charge to mandate a charity care requirement for nonprofit hospitals. A federal charity care mandate surfaced in the summer of 2007 in a Senate Finance Committee minority staff “discussion draft” on hospital tax exemption. Among other things, this document suggested a charity care standard requiring exempt hospitals to spend a minimum of 5% of the greater of operating expenses or operating revenues spent on charity care.⁴⁷ At the time of this writing (June, 2009), the charity care mandate idea is still alive and bubbling at the Senate Finance Committee, where it has been incorporated into discussions regarding President Obama’s health care reform initiative.⁴⁸

B. No Charity for the Middle Class?

Despite the IRS’s shift in 1959 from a redistributive view of the word “charitable” to a broad common-law view emphasizing “community benefit,” services specifically aimed at the “middle class” have been curiously off-limits for purposes of federal tax exemption even though they often display rather clear benefits to the general community served. For example, in Rev. Rul. 70-585,⁴⁹ the IRS examined three cases in which nonprofit organizations were formed to construct housing. In Situation 1 in the ruling, the organization in question built new housing and renovated existing housing for sale at below-market mortgage rates and terms to low-income families who could not otherwise secure financing. In Situation 2, the organization constructed housing for sale to “low and moderate income” minority families in an area that was racially segregated, apparently from “local discrimination” (according to the ruling). In Situation 3, an organization was formed to rehabilitate housing units in a city area where median income was “lower than in other sections of the city” and the housing was “generally old and deteriorated.” The housing would be rented at cost to “low and moderate” income individuals. In Situation

⁴⁷ Senate Finance Committee – Minority, *Tax Exempt Hospitals: Discussion Draft 7-8 (2007)* available at <http://finance.senate.gov/press/Gpress/2007/prg071907a.pdf>.

⁴⁸ *E.g.*, Robert Pear, *Hospitals Mobilizing to Fight Proposed Charity Care Rules*, N.Y. Times, May 31, 2009, available at http://www.nytimes.com/2009/06/01/us/politics/01health.html?_r=1&scp=1&sq=hospitals%20mobilizing&st=cse.

⁴⁹ 1970-2 C.B. 115.

4, an organization building new housing aimed specifically at moderate income families in a neighborhood where land values and housing prices had essentially “frozen out” moderate income individuals. Again, the proposal was to rent the units at cost.

In all the cases in the ruling, the organizations in question obtained funding from federal and state housing programs as well as private contributions. Nevertheless, the IRS found that the groups in Situations 1-3 qualified for exemption, while the group in Situation 4 did not. According to the IRS, the purpose of the group in Situation 4 was not charitable, because its program “is not designed to provide relief to the poor or to carry out any other charitable purpose within the meaning of the regulations . . .”

The resistance to classifying services aimed at the middle class also is evident from rulings related to legal assistance and disaster relief. In Rev. Rul. 69-161,⁵⁰ the IRS recognized that providing legal services to the poor would qualify as a charitable purpose, and in Rev. Rul. 78-428,⁵¹ amplified the earlier ruling to make clear that charging a fee based on ability to pay would not disqualify an organization whose services were aimed at the poor. But exemption for legal services to persons other than the poor is extremely limited – the Service has approved exemption for “public interest law firms” that undertake cases in the public interest (e.g., “test” cases in broad public interest areas such as the first amendment, government regulation, etc.) but only under a very strict set of guidelines that emphasizes the lack of commercial viability for the cases (e.g., private law firms would be unlikely to be engaged by litigants or otherwise take the case).⁵² Though the IRS has apparently not ruled directly on exemption for legal services directed at moderate-income individuals, at least one prominent casebook agrees that under current precedent, such an exemption would be unlikely.⁵³

⁵⁰ 1969-1 C.B. 149.

⁵¹ 1978-2 C.B. 147.

⁵² See Rev. Rul. 75-74, 1975-1 C.B. 152 (“ and Rev. Proc. 92-59, 1992-2 C.B. 411.

⁵³ FISHMAN AND SCHWARZ, *supra* note 9, Teachers Manual at 67 (opining that an organization formed to provide legal services to the middle class at cost “is unlikely to make the grade, despite the altruism of its founders and their adherence to the nondistribution constraint, because it is essentially providing a commercial service in competition with small law firms and sole practitioners.”).

On the disaster relief front, the IRS has struggled to define the appropriate bounds of charity. Disaster relief has long been recognized as a charitable purpose,⁵⁴ but after the Oklahoma City bombing and again after the 9/11 attacks, questions arose about the ability of charities to make economic grants (in the form of cash or property) to individuals who have suffered from a disaster, particularly if such grants were not to those traditionally classified as “poor” or under some other specific financial need.⁵⁵ At one point, the IRS had suggested that such grants might violate the private benefit doctrine, stating in a letter to Oklahoma City charities after the bombing there that although one did not have to be “poor” to be eligible for disaster relief, “an outright transfer of funds based solely on an individual’s involvement in a disaster or without regard to meeting the individual’s particular distress or financial needs would result in excessive private benefit.”⁵⁶ After the 9/11 attacks, however, the IRS issued Notice 2001-78 stating that it would treat payments made by charities to disaster victims and their families as related to the charity’s exempt purpose as long as such grants were made “in good faith using objective standards.”⁵⁷ Nevertheless, the private benefit issue raised enough concern that after 9/11, Congress enacted legislation that specifically provided that cash grants to 9/11 victims would be considered as made for an exempt purpose, essentially removing the private benefit analysis from payments made for 9/11 disaster relief.⁵⁸ The current IRS position on disaster relief, however, appears to have returned to the proposition that the charity must make some kind of “needs” assessment when appropriate and to document the basis for its grants.⁵⁹

⁵⁴ Robert A. Katz, *A Pig in a Python: How the Charitable Response to September 11 Overwhelmed the Law of Disaster Relief*, 36 IND. L. REV. 251, 266-67 (2003); Catherine E. Livingston, *Disaster Relief Activities of Charitable Organizations*, 35 EXEMPT ORG. TAX REV. 153 (2002).

⁵⁵ FISHMAN & SCHWARZ, *supra* note 9, at 395-99.

⁵⁶ Livingston, *supra* note 54 at 154; *see* Katz, *supra* note 54 at 286-87.

⁵⁷ IRS Notice 2001-78, 2001-50 I.R.B. 1.

⁵⁸ Victims of Terrorism Tax Relief Act, P.L. 107-134, Section 104 (2002). *See* FISHMAN & SCHWARZ, *supra* note 9, at 399; Katz, *supra* note 54 at 292-93; Livingston, *supra* note 54, at 154.

⁵⁹ INTERNAL REVENUE SERVICE, PUBLICATION 3833: DISASTER RELIEF 7-9 available at <http://www.irs.gov/pub/irs-pdf/p3833.pdf>.

The notion that services offered to a particular economic class other than the poor cannot be exempt can be seen in other cases as well. In *Federated Pharmacy Services*,⁶⁰ the 8th Circuit Court of Appeals rejected exemption for an organization formed to sell drugs to the elderly or handicapped at cost (note, not specifically the poor) on the grounds that the pharmacy was simply engaged in a commercial service. In the environmental preservation area, the IRS has resisted exemption for organizations that preserve farmland as working farms, arguing that the land involved had no particular “ecological significance” and that commercial farming is not an exempt purpose.⁶¹ Exemption for health/recreation facilities similarly seems keyed to whether the organization seeking exemption insures that whatever fees they impose do not “price out” significant segments of the community.⁶² In any event, these cases overall signal that the IRS is less than completely dedicated to the broad definition of charity set forth in the 1959 regulations, and that relief of the poor is a significant, if not controlling, factor in some areas of exemption law.

C. Educational Institutions and Endowments

The current pressure on universities to spend more of their endowments appears to have begun in earnest when Grinnell College announced in 2006 a 12.7% tuition increase for the 2007-08 academic year, despite reporting a banner investment year that pushed their endowment well over \$1 billion.⁶³ Grinnell seemed not to have processed the fact that their senior home state senator, Chuck Grassley, had made tax-exemption and nonprofit accountability his personal area of expertise on the Senate Finance Committee. Shortly after the Grinnell announcement, Grassley, then chair of the Finance Committee, called for hearings on tax benefits in higher education, which took place in December,

⁶⁰ 72 T.C. 687 (1979), *aff'd*, 625 F.2d 804 (8th Cir. 1980).

⁶¹ *See, e.g.*, Rev. Rul. 78-384, 1978-2 C.B. 174, *Dumain Farms v. Commissioner*, 73 T.C. 650 (1980) (Tax Court rejected IRS arguments that experimental working farm was not exempt, noting that the entity in questions promoted sound soil conservation techniques and shared research results. *See also*, William T. Hutton, *Agricultural Preservation: Contesting the Application of Revenue Ruling 78-384*, THE BACK FORTY (Sept./Oct. 1992).

⁶² *See* Virginia Richardson, Roderick Darling and Marvin Freidlander, *Health Clubs*, in IRS FY2000 EXEMPT ORGANIZATIONS CONTINUING PROFESSIONAL EDUCATION TEXT at 1, 6.

⁶³ *See* Waldeck, *supra* note 2, at 1803 n.37, 1825 (table).

2006.⁶⁴ In his opening statement for the December, 2006 hearing, Grassley opined that colleges and universities had responded to rising education costs with “a bad triple play: big tuition increases; expanding endowments; and now million-dollar salaries for college Presidents.”

The heat on endowments shot up several degrees in 2007 as the result of Finance Committee hearings on a seemingly unrelated issue. In September, 2007, the Committee held a hearing on *Offshore Tax Issues: Reinsurance and Hedge Funds*⁶⁵ that included testimony by Lynne Munson, Adjunct Fellow at the Center for College Affordability and Productivity. In her testimony, Munson targeted the billion-dollar plus endowments of many elite universities (though she also specifically noted “little 1500-student Grinnell College”) and what she characterized as “miserly” payouts.⁶⁶ She noted that the endowments of the top 25 colleges and universities exceeded those of the 25 largest private foundations, and that if gasoline and milk prices had increased as much as college tuition since 1980, they would cost \$9.15 and \$15 per gallon, respectively.⁶⁷

Shortly after the 2007 hearing, Grassley issued a press release excoriating colleges and universities for their tuition hikes in light of their large endowments and investment returns, and suggested that he would pursue a mandatory pay-out requirement for large university endowments similar to that imposed on private foundations.⁶⁸ He followed his press release with a letter, co-signed by new Finance Chair Max Baucus, that requested information on endowments, tuition and endowment spending from 136 of the wealthiest

⁶⁴ Senate Finance Committee, *Report Card on Tax Exemptions and Incentives for Higher Education: Pass, Fail, or Need Improvement?*, December 5, 2006, transcripts and statements available at <http://finance.senate.gov/sitepages/hearing120506.htm>.

⁶⁵ Senate Finance Committee, *Offshore Tax Issues: Reinsurance and Hedge Funds*, September 26, 2007, transcripts and statements available at <http://finance.senate.gov/sitepages/hearing092607.htm>.

⁶⁶ Senate Finance Committee, *supra* note 62, Statement of Lynne Munson at 2, available at <http://finance.senate.gov/hearings/testimony/2007test/092607testlm.pdf>.

⁶⁷ *Id.* at 3.

⁶⁸ Chuck Grassley, *Endowments May Help Rein In Tuition Hikes* (press release, October 29, 2007) available at http://grassley.senate.gov/news/Article.cfm?customel_dataPageID_1502=14508. The mandatory pay-out rate for private foundations is 5% of the foundation’s net asset value per year. I.R.C. Section 4942. *See generally*, FISHMAN & SCHWARZ, *supra* note 9, at 788.

colleges and universities.⁶⁹ Some major universities were quick to take the hint. Not long after Grassley's press release and letter, Harvard, Yale, Stanford and others announced programs to dramatically increase student financial aid.⁷⁰

While the recent economic downturn and stock market decline has muted further calls from Grassley for mandatory payouts,⁷¹ scrutiny of university endowments will surely continue. If nothing else, the skyward trek of tuition at top institutions, and the inevitable rebound in investments will keep this issue in the sights of policy makers.⁷²

III. The Redistributive Model in Federal Tax Exemption: Analysis

A. Bad Policy; Inconsistent Policy.

The threads of redistributive policy set forth in Part II of this paper appear to be both contrary to the traditional, broad view of charity at common law that the IRS purported to adopt in the 1959 regulations, at odds with other areas of exemption that clearly do not require any redistributive bent, and at the same time incredibly bad overall policy.

Take, for example, the push to impose a strict charity care standard for exemption of nonprofit hospitals. While one certainly can appreciate the need for more health services for the uninsured poor in a country where estimates put the number of uninsured at roughly 47 million people,⁷³ this effort stands in curious contrast to dozens of other cases of exemption where no poor relief is required. The IRS does not appear interested

⁶⁹ Karen Arenson, *Senate Looking at Endowments as Tuition Rises*, NY Times, Jan. 25, 2008, available at <http://www.nytimes.com/2008/01/25/education/25endowments.html>.

⁷⁰ Harvard announced extending financial aid to families with incomes of up to \$180,000 per year; Yale one-upped Harvard by using a \$200,000-per-year dividing line, while Stanford announced that it would not charge tuition at all to families earning \$100,000 per year or less, and would even throw in room and board for students of families with incomes below \$60,000. *See id*; *First Harvard and Yale ... Now Stanford? Free Education to Low- and Middle-Income Students*, DiversityInc, Feb. 21, 2008, available at <http://www.diversityinc.com/public/3117.cfm>.

⁷¹ Clifford M. Marks and Nathan C. Strauss, *Senator Grassley Tones Down Threats on Endowment Spending*, Harvard Crimson, Sept. 9, 2008, available at <http://www.thecrimson.com/article.aspx?ref=523990>.

⁷² *See* Waldeck, *supra* note 2, at 1797.

⁷³ *See* Center on Budget and Policy Priorities, *The Number Of Uninsured Americans Is At An All-Time High*, available at <http://www.cbpp.org/cms/?fa=view&id=628> (citing 2008 census data).

in knowing how many homeless people the Metropolitan Opera admits to its performances each year or that pass through the doors of the Museum of Modern Art. Religious organizations are not required to file a “Schedule R” to form 990 detailing their expenditures on behalf of the poor, in contrast to the new Schedule H demanded of nonprofit hospitals.⁷⁴ Thus if one believes the IRS’s statement in Rev. Rul. 69-545 that providing health care for the benefit of the general community is a charitable purpose at common law, the push to re-impose a charity care standard seems curiously at odds with the IRS’s stated adherence to common-law standards of charity and the requirements for exemption in other areas.⁷⁵

It is also undoubtedly bad health policy. As I have detailed numerous times in the past,⁷⁶ imposing a strict charity care standard for exemption of nonprofit hospitals will almost certainly push those hospitals toward providing the required amount of charity care (and not a penny more) at the expense of other unprofitable health care services (e.g., a burn unit; emergency psychiatric care) that at least some empirical evidence suggests are more likely to be offered by nonprofits.⁷⁷ While I have heavily criticized the current community benefit formulation for hospital exemption as far too broad⁷⁸ and certainly have no argument with better accountability for exempt hospitals, it is curious that the law seems relatively unconcerned about accountability in so many other exemption cases.

The same general observations are true of the other two areas detailed in Part II. Organizations providing affordable legal services to the middle class are not eligible for

⁷⁴ “Churches” (a subset of the broader “religious organization” category of 501(c)(3)), of course, are not required to file form 990 at all.

⁷⁵ One might argue that this difference in treatment results from the fact that religious and educational organizations are specifically named in 501(c)(3) as exempt, whereas hospitals are not. The U.S. Supreme Court, however, has made clear that the enumeration of certain kinds of groups (e.g., religious, educational, scientific) does not create a per-se right to exemption, and that in all cases, and organization must prove it meets the common-law standards of charity in order to qualify for exemption. *Bob Jones University v. U.S.*, 461 U.S. 574 (1983). Thus whatever standard the IRS chooses to apply to determine whether an organization is charitable should be the same for religious organizations as for nonprofit hospitals.

⁷⁶ E.g., John D. Colombo, *Why We Need An Alternative to Community Benefit: Evidence From the IRS Hospital Compliance Project Final Report*, 63 Exempt Org. Tax Rev. 479, 482 (2009).

⁷⁷ E.g. Jill Horwitz, *Why We Need The Independent Sector: The Behavior, Law and Ethics of Not-For-Profit Hospitals*, 50 U.C.L.A. L. REV. 1345 (2003).

⁷⁸ See, e.g., John D. Colombo, *The Failure of Community Benefit*, 15 Health Matrix 29 (2005).

exemption, but “public interest law firms” appear to have no redistributive limits. One cannot qualify for exemption if the purpose is to build affordable middle-class housing in the Hamptons, but offering symphony performances in well-heeled surroundings in New York’s upper-west-side is perfectly OK. “Environmental protection” writ large appears to be a valid charitable purpose, but not if the subject is preservation of farmland.

Meanwhile, the push to require universities with large endowments to spend more annually or limit their tax benefits would appear to be a particularly hare-brained implementation of redistributive policy. While it is true that Senator Grassley’s saber-rattling over endowments led to a few highly-publicized cases of wealthy universities providing increased student financial aid,⁷⁹ anyone with even the slightest familiarity with things financial should understand that money is fungible, and requiring universities to “spend more” will not necessarily mean that the spending will reduce tuition over the long run or provide greater opportunities for low and middle-income students; the increased spending could easily wind up in higher faculty or administrator salaries or new/remodeled buildings and capital equipment.⁸⁰ Similarly, reducing the tax benefits to such universities simply invites them to ratchet up tuition to make up the difference, hardly a well-aimed redistributive policy.⁸¹

There is a legitimate debate concerning current spending from charitable endowments, but that debate has little to do with redistribution to a specific segment of current society. Rather, as Michael Klausner and Henry Hansmann have pointed out, the

⁷⁹ See note 70, *supra*.

⁸⁰ See Waldeck, *supra* note 2 at 1815-1816 (“Advocates of a mandatory spending rule assume that the increased endowment spending would decrease tuition; that is, an endowment would bear some of the costs that are currently borne by students. Contrary to this assumption, however, a mandatory spending rule could have the unintentional effect of raising tuition across the board. “). Waldeck notes that a mandatory increase in endowment spending could lead to riskier investments as universities try to maintain overall endowment levels and growth, and could also lead to an increase in the “arms race” over facilities and equipment, rather than reduce tuition.

⁸¹ Of course, the other side of this argument is that current educational tax benefits aimed at students or their parents, such as the HOPE tax credit, simply invite colleges and universities to raise tuition so that the net cost to the student, after accounting for the benefit, remains constant. See Evelyn Brody, *Charities in Tax Reform: Threats to Subsidies Overt and Covert*, 66 TENN. L. REV. 687, 709 (1999) (“Moreover, institutions of higher education can capture the benefit by raising tuition or by offsetting internal financial aid (or both).”).

key part of the endowment spending debate involves questions of inter-generational cost-effectiveness and the issue of inter-generational equity.⁸² On the cost-effectiveness front, Klausner notes that the relevant considerations are (1) how great a return to society a current expenditure creates versus a future expenditure, and (2) whether the future generations are expected to be wealthier or poorer overall than the current generation.⁸³ If a current expenditure would produce a compound return to society greater than the expected financial return on the endowment's investments, spending now should be preferred. Similarly, if future generations are expected to be wealthier than the current generation overall, delaying spending to future generations is in effect a transfer of wealth from a poorer generation (the current one) to a wealthier generation in the future, which presumably would be a bad policy choice. On the intergenerational equity front, Klausner notes (like Hansmann, below) that "equity" is not the same as "efficiency" – rather, the equity question is essentially an ethical one, centered around whether the current generation should be asked to sacrifice, even if that sacrifice would produce net gains in the future.⁸⁴

In the university context, Henry Hansmann has argued strongly that deferring current spending in favor of future spending is irrational from a number of perspectives.⁸⁵ If personal wealth continues to grow, future students can be expected to be more wealthy than current students; hence the decision by a university to save instead of spend results in a transfer from a poorer generation (the current one) to a future generation. If the costs of education rise in the future (as has been true in the past), then deferring consumption of cheaper education today in favor of more expensive education in the future is a strange economic choice. Moreover, even if a strong case existed for saving for the future, it is unclear that having universities place resources in financial investments, instead of

⁸² See Waldeck, *supra* note 2 at 1805-07; Michael Klausner, *When Time Isn't Money: Foundation Payouts and the Time Value of Money*, 41 EXEMPT ORG. TAX REV. 421 (2003).

⁸³ Klausner, *supra* note 79, at 426.

⁸⁴ *Id.* at 427.

⁸⁵ Henry Hansmann, *Why Do Universities Have Endowments?*, 19 J. LEGAL STUD. 3, 14 (1990).

spending on biotechnology research which might result in a major breakthrough in disease-fighting, is the right way to do it.

Sarah Waldeck has recently echoed many of Hansmann's criticisms. In an essay published in early 2009, Waldeck provided a detailed critique of the arguments in favor of "mega-endowments" (those above \$1 billion in assets).⁸⁶ Like Hansmann, Waldeck notes that future generations are likely to be richer, not poorer, than the current generation, meaning that pouring money into endowment rather than spending it currently is really a wealth transfer from a poorer generation to a wealthier one.⁸⁷ In fact, Waldeck notes that in the 20 years since Hansmann published his critique of the intergenerational equity argument, similar critiques have been published routinely in the *Chronicle of Higher Education* without a single written defense by universities.⁸⁸ Waldeck also demolishes the "saving for a rainy day" defense, along with the "we can't spend it because it is restricted" argument and concludes that tax policy changes are necessary to change the incentives for university trustees to emulate Scrooge McDuck's daily dives into his money bin.⁸⁹

In short, there are a number of arguments that would support encouraging universities to spend more and discourage them from racking up "mega-endowments" (as Waldeck calls them), but these arguments have virtually nothing to do with wealth

⁸⁶ Waldeck, *supra* note 2.

⁸⁷ *Id.* at 1806. Waldeck cites the most current Social Security Trustees report for various scenarios concerning future growth and Neil Buchanan's withering critique of the argument that the Social Security system is in danger of collapsing. Even under the most pessimistic economic growth scenarios, GDP is expected to rise by 124% by 2080, and intermediate scenarios show GDP *tripling* over that time frame. See Neil H. Buchanan, *What Do We Owe Future Generations?*, 77 GEO. WASH. L. REV. ____ (2009) available at http://papers.ssrn.com/sol3/papers.cfm?abstract_id=1121217.

⁸⁸ Waldeck, *supra* note 2, at 1806.

⁸⁹ For those of you who never read comic books or watched 1960's era cartoons, try this link: http://en.wikipedia.org/wiki/Scrooge_McDuck. A search of YouTube might also be helpful.

Waldeck does not agree, however, that a mandatory spending rule (e.g., a 5% spending requirement at private foundations) is the best solution to the problem – in fact, she worries that such a rule will actually end up exacerbating the problems with spiraling tuition. Instead, Waldeck prefers changes to tax policies targeted at donors, such as a rule that to qualify for a deduction, a charitable gift must be spent within a certain time frame – say, 25 years. While Waldeck acknowledges that such a rule is unlikely to completely overcome the other non-tax incentives for making endowment gifts, she argues that it would turn some significant number of donors toward current spending and might help change the "edifice" culture of major university donors. Waldeck, *supra* note 2, at 1818-22. See also, Evelyn Brody, *Charitable Endowments and the Democratization of Dynasty*, 39 ARIZ. L. REV. 873 (1997).

redistribution among members of the current generation. Moreover, if wealth redistribution among members of the current generation is the goal, the current proposals are woefully inadequate to address that goal. In fact, if redistribution among members of the current generation is the goal, one could argue that the best policy would be to encourage universities to charge the maximum tuition possible to students (and parents) that can afford it and couple that with some sort of “sliding scale” financial aid (perhaps similar, though more expansive, to the kinds of formulas used by some nonprofit hospitals to determine charity care eligibility) for students below the “sticker price” income level.

B. A Back-handed Commerciality Test?

Despite the above critique of the policy rationales for the redistributionist theme in federal tax exemption, there is an explanation of these “anomalies” that may make some sense, at least from a practical standpoint, if not a theoretical one. This explanation is that the redistributive notion appears to come to the forefront of exemption law when the entities in question start to more heavily resemble for-profit businesses than “traditional” charities in their operations. The push for a strict charity care standard for exemption of nonprofit hospitals has followed the transformation of nonprofit hospitals from what were essentially homeless shelters to fee-for-service enterprises as concerned (or more concerned) about the bottom line than service to the poor.⁹⁰ As nonprofit hospitals began to more closely resemble the operational philosophy of Intel, it has become harder for these organizations to demonstrate their differences from for-profit counterparts that annually pay millions in income and property taxes. Accordingly, courts and policy-makers have increasingly turned to measuring whether hospitals provide free services to the poor as the key criterion for “charitableness.”⁹¹

⁹⁰ For a history of the evolution of the modern hospital, see CHARLES E. ROSENBERG, *THE CARE OF STRANGERS: THE RISE OF AMERICA’S HOSPITAL SYSTEM* (1987); PAUL STARR, *THE SOCIAL TRANSFORMATION OF AMERICAN MEDICINE* (1982); and ROSEMARY STEVENS, *IN SICKNESS AND IN WEALTH: AMERICAN HOSPITALS IN THE TWENTIETH CENTURY* (1989).

⁹¹ This trend has been especially noticeable at the state level. In 1985, the Utah state supreme court upheld the revocation of tax exemption for two nonprofit hospitals run by Intermountain Health Care (created as a non-denominational health care spin-off by the Church of Latter Day Saints) on the grounds that “charity” requires some identifiable “gift to the community” such as free care for the poor. *Utah County v.*

This same commerciality thread can be seen in the cases dealing with middle-class services. As noted above, the Eighth Circuit in *Federated Pharmacy Services* based its denial of exemption on the fact that the pharmacy in question was merely a commercial enterprise, though sales at cost are not usually a feature of commercial businesses⁹² and the IRS attacked farm preservation as nothing more than preserving a commercial enterprise.⁹³ Certain YMCA's are beginning to resemble upscale for-profit health clubs, and an organization whose purpose is to build "moderate income" housing looks an awful lot like a regular real-estate developer (though again one can certainly argue that providing such housing "at cost" differentiates such an organization from a commercial business).

The attack on university endowments also can be seen as an expression of frustration with the dividing line between commercial activities and charitable ones. Part of Senator Grassley's mantra concerning university endowments was the ever-increasing cost of higher education for students, and tuition constitutes 70% of the revenue for virtually all private colleges and universities and nearly half even for public institutions.⁹⁴ Tuition revenue is simply an exchange of money for educational services received, not unlike any market service transaction. Meanwhile, universities enter into a variety of joint ventures with for-profit companies,⁹⁵ build hotels and research parks to bolster the bottom line,⁹⁶ and in many cases have turned student athletics into little more than wildly

Intermountain Health Care, 709 P.2d 265, 276 (Utah 1985). The Illinois Fourth District Court of Appeals recently repeated this theme in the *Provena Covenant Hospital* tax exemption dispute, stating that "To be charitable, an institution must give liberally." *Provena Covenant Medical Center v. Department of Revenue*, 384 Ill. App. 3d 734 (2008). See generally, John D. Colombo, *Provena Covenant Tax Exemption Saga Continues*, 62 EXEMPT ORG. TAX REV. 29 (2008). For an overview of the state trend in general, see Evelyn Brody's contribution to this conference.

⁹² See text and note at note 59, *supra*.

⁹³ See text and note at note 60, *supra*.

⁹⁴ Lester M. Salamon, *AMERICA'S NONPROFIT SECTOR, A PRIMER* 99 (2d ed. 1999).

⁹⁵ See Michael I. Sanders, *JOINT VENTURES INVOLVING TAX EXEMPT ORGANIZATIONS* at section 1.4 (3d ed. 2009).

⁹⁶ A quick Google search on "university research park" found over 50 listings. The web page for the research park at my home institution, the University of Illinois, unabashedly touts the research park as "an environment where technology-based businesses can work with the research faculty and students at UIUC to take advantage of opportunities for collaborative research and easy access to University labs, equipment, and services."

successful minor leagues for the NBA and NFL.⁹⁷ In many respects, universities appear to some as headed toward the same Rubicon as nonprofit hospitals, where the difference between “charity” and “business” increasingly blurs.⁹⁸ It is hardly surprising, therefore, that policy makers have begun to fixate on some concrete measure of charity (in this case, using endowment funds to reduce tuition cost) that is similar to the “charity care” debate surrounding nonprofit hospitals.

Finally, the recent action by the English Charity Commission to deny charitable status to private schools that failed to provide enough scholarships for those unable to pay also tracks this commerciality analysis. In essence, the Commission’s view is that simply providing services for a fee is not itself a public benefit, a view that tracks the IRS’s tortured journey through hospital tax exemption outlined in Part II above.

In short, my explanation for the resurgence of the redistributive model of charity is that this emphasis has paralleled the commercialization of charitable enterprises. When churches have their own record labels and amusement parks,⁹⁹ one is perhaps less inclined to accept the “charitable” label on its face, and demand more evidence of traditional charitable activity as a precondition to exemption – helping the poor, for example.

⁹⁷ See, e.g., John D. Colombo, *The NCAA, Tax Exemption and College Athletics*, 2010 ILL. L. REV. ____ (forthcoming 2010). A current draft is available at <http://papers.ssrn.com/abstract=1336727>

⁹⁸ Robert Zensky, the director of the University of Pennsylvania's Learning Alliance for Higher Education, made a similar point in his testimony before the Knight Commission on Intercollegiate Athletics on May 12, 2009, when he opined that universities had lost their “specialness” and sense of values in the eyes of many. See *Athletics, Antitrust and Amateurism*, Inside Higher Ed, May 13, 2009 available at <http://www.insidehighered.com/news/2009/05/13/knight>.

⁹⁹ E.g., “World Changers Ministries, for instance, operates a music studio, publishing house, computer graphic design suite and owns its own record label. The Potter's House also has a record label as well as a daily talk show, a prison satellite network that broadcasts in 260 prisons and a twice-a-week Webcast. New Birth Missionary Baptist Church has a chief operating officer and a special effects 3-D Web site that offers videos-on-demand. It publishes a magazine and holds Cashflow 101 Game Nights. And Lakewood Church, which recently leased the Compaq Center, former home of the NBA's Houston Rockets, has a four-record deal and spends \$12 million annually on television airtime.” Luisa Kroll, *MegaChurches, Megabusinesses*, available at http://www.forbes.com/2003/09/17/cz_lk_0917megachurch.html.

C. The Redistribution Bent, Historical Perspectives, and Theory

1. History

Whatever the explanation may be, the current fascination by some commentators with defining charity as almost exclusively associated with helping the poor is contrary to the historical definitions of charity and conflicts with all the theories on the table for explaining charitable tax exemption. In addition, proposals to align charitable tax incentives with redistribution to the poor in effect represent a choice of one view of distributive justice as the prevailing rationale for exemption without much in the way of critical examination of what that choice means for the charitable sector generally, or other views of distributive justice (or economic efficiency) that also might define the scope of the charitable sector.

On the historical front, while relief of the poor certainly has been a major part of the definition of charity for centuries, it has never been the only part. Indeed, tax-exemption for charitable organizations originally had nothing at all to do with redistribution to the poor. Rather, the practice can be traced to the simple proposition that human beings shouldn't try to tax God: churches were the original tax-exempt entities.¹⁰⁰ Exemption for educational institutions was simply an extension of the religious exemption, since virtually all schools prior to the Reformation were church-affiliated. The 1601 Elizabethan Statute of Charitable Uses certainly highlighted the relief of the poor as a charitable purpose (and was passed as part of the "poor laws" enacted at that time¹⁰¹), but also includes "schools of learning, free schools and scholars in universities," as well as

¹⁰⁰ See COLOMBO AND HALL, *supra* note 8, at 3 ("one historian reports that the "economic equilibrium of the state was endangered" by the fact that the tax exempt temples owned fifteen percent of the cultivable land and vast amounts of slaves and other personal property during the reign of Ramses III about 1200 B.C. Ezra 7:24 commands that "it shall not be lawful to impose toll, tribute, or custom upon . . . priests . . . or ministers of the house of God," and Genesis 47:24 declares that "Joseph made it a law over the land of Egypt unto this day, that Pharaoh should have the fifth part; except the land of the priests only, which became not Pharaoh's.")

¹⁰¹ James J. Fishman, *The Political Use of Private Benevolence: The Statute of Charitable Uses*, available at <http://digitalcommons.pace.edu/lawfaculty/487>.

“repair of bridges, ports, havens, causeways, churches, sea-banks and highways . . . maintenance for houses of correction, . . . help of young tradesmen” and so forth.¹⁰²

Moving forward somewhat in the historical timeline, Lord McNaughten in *Commissioners v. Pemsel* (the seminal case defining charity for purposes of English common-law) stated “‘Charity’ in its legal sense comprises four principal divisions: trusts for the relief of poverty; trusts for the advancement of education; trusts for the advancement of religion; and trusts for other purposes beneficial to the community, no falling under any of the preceding heads.”¹⁰³ Relief of poverty in this formulation was simply one of four major categories of charity, including an all-encompassing “other purposes beneficial to the community.” In the United States, Chief Justice Gray of the Massachusetts Supreme Court defined charity in 1867 as a gift “for the benefit of an indefinite number of persons, either by bringing their minds and hearts under the influence of education or religion, by relieving their bodies from disease, suffering or constraint, by assisting them to establish themselves in life, or by erecting or maintaining public buildings or works or otherwise lessening the burdens of government.”¹⁰⁴ The Restatement Third of the Law of Trusts is shorter and more opaque: “A trust purpose is charitable if its accomplishment is of such social interest or benefit to the community as to justify permitting the property to be devoted to the purpose in perpetuity and to justify the various other special privileges that are typically allowed to charitable trusts.”¹⁰⁵ Like English law, neither of these formulations restrict charity to help for the poor.

Of course, tax law need not be (and perhaps should not be) consistent with the historical common-law definition of charity.¹⁰⁶ In fact, I have argued in the past that tying

¹⁰² An Act to Redress the Mis-Employment of Lands, goods and Stocks of Money Heretofore Given to Certain Charitable Uses, 1601, 43 Eliz., ch. 4, reprinted in 7 STAT. AT LARGE 43 (Eng. 1763).

¹⁰³ 1891 App. Cas. 531 (H.L.).

¹⁰⁴ *Jackson v. Phillips*, 14 Allen 539, 556 (Mass. 1867).

¹⁰⁵ Restatement of the Law of Trusts (3d), Section 28, comment a (2003).

¹⁰⁶ In a paper delivered at the 2002 NCPL conference, John Simon noted and commented on this issue of “fit” between the federal income tax law and the common-law definition of charity, noting that tax law was sometimes more expansive than the common law in granting exemption (e.g., exemption for the foundation that temporarily owned the Kansas City Royals) and at times more restrictive (for example, denying a tax deduction for a gift to a stranger in need, such as donations to the Jessica McClure fund). See John G.

tax-exemption to a body of law that primarily defines when a trust will not violate the Rule Against Perpetuities is more than a bit silly.¹⁰⁷ Nevertheless, to the extent that the IRS purports to adopt the common law definition as controlling for tax purposes, that definition clearly encompasses far more than relief of the poor.

2. Theory

If one does accept the notion that the definition of charity for tax exemption purposes should not or need not completely track the historical common-law definition, then perhaps a better viewpoint would be to turn to the theoretical basis for exemption and see how well a restricted definition of charity works in that light. Unfortunately, one of the continuing problems with federal tax exemption law is that there is no accepted theory for why exemption exists; exemption in the federal income tax law did not result from a reasoned debate about the theoretical need for exemption, but rather simply adopted historical practice without much thought. Beginning about 1980, however, scholars began to offer differing theoretical explanations for exemption that either tracked, or more often constricted, the common-law definition. At last count, these scholars had offered at least ten different theoretical explanations for exemption.

Despite this lack of theoretical consensus, what we can observe that is important for these purposes is that a conception of charity limited to relief for the poor runs counter to literally all of the theoretical explanations that have surfaced for tax exemption. While each takes a somewhat different overall approach, a common theme of all these theories is that charities supply some sort of good or service or “way of doing things” that is not replicated in the private market or by government – some kind of public good or quasi-public good that otherwise would not exist. Tax-exemption in turn supplies an economic incentive for the production of whatever “thing” it is that is not being provided by the private market or government. The “thing” supplied might be a specific item not available from the private market (e.g., symphonic music) or something as diffuse as a “nonprofit

Simon, *Is There A Law of Charity?*, National Center on Philanthropy and the Law 2002 Conference on *Defining Charity: A View from the 21st Century*.

¹⁰⁷ COLOMBO AND HALL, *supra* note 8, at 35-41.

ethic” that takes a different (and presumably unique) approach to providing something that might otherwise be available in the market – for example, a nonprofit hospital might approach patient care in a different manner than a for-profit one, even though the services provided (e.g., a heart by-pass) are ultimately the same.

So, for example, the classic “quid-pro-quo” theory of exemption posits that tax exemption is a rough “quid-pro-quo” to charities for doing things that otherwise would become the burden of (and paid for by) government.¹⁰⁸ The “community benefit” theory broadens this approach by justifying tax exemption not just for specific items done by charities that the government might otherwise have to pay for, but rather to all sorts of “good things” done by charities that are not otherwise being done by the private market or government directly or which differ in some significant way from similar services provided by the market or government.¹⁰⁹ Several theories of exemption (the “contract failure” theory of Henry Hansmann,¹¹⁰ the “risk compensation” theory of Nina Crimm¹¹¹ and the “donative theory” that I constructed with Mark Hall¹¹²) are based explicitly on economic theory, again focusing on the role of charities in supplying goods or services not available in the private market. Several other theories would grant tax exemption essentially as a reward for enhancing our pluralistic society. Thus Rob Atkinson justifies exemption as a

¹⁰⁸ See FISHMAN & SCHWARZ, *supra* note 9, at 76; COLOMBO & HALL, *supra* note 8, at 5-6 (discussing how nonprofits “do good” for society), 22-23 (noting the distinction between tax-base and subsidy rationales for charitable tax exemption); Rob Atkinson, *Theories of the Federal Income Tax Exemption for Charities: Thesis, Antithesis, and Syntheses*, 27 STETSON L. REV. 395, 403-04 (1997).

¹⁰⁹ See FISHMAN & SCHWARZ, *supra* note 9, at 76; COLOMBO & HALL, *supra* note 8, at 63; Atkinson, *supra* note 101, at 403-04.

¹¹⁰ See generally Henry Hansmann, *The Rationale for Exempting Nonprofit Organizations from Corporate Income Taxation*, 91 YALE L.J. 54, 72-75 (1981) (proposing efficiency rationale that suggests charitable tax exemption is a capital subsidy that compensates for nonprofit organizations’ struggles to build capital, because of the non-distribution constraint, when nonprofits better serve the public than their for-profit analogs).

¹¹¹ Nina J. Crimm, *An Explanation of the Federal Tax Exemption for Charitable Organizations: A Theory of Risk Compensation*, 50 FLA. L. REV. 419, 424-25 (1998) (proposing that “tax exemption is a non-volatile expected return to compensate rational charitable organizations for undertaking the provision of ‘inherently risky’ public goods and services” and that determining if a nonprofit organization should be tax-exempt “requires taking into account an organization’s evolution, the need to maximize inter-generational utility, and the application of dynamic gamesmanship theory”).

¹¹² *Colombo and Hall, supra* note 8, at 99-113 (explaining that exemption is justified to provide public support to organizations that supply goods or services that are not supplied by the private market or government and which the public desires – as signaled by their making significant donations to support these entities).

reward for altruism which should be encouraged in its own right;¹¹³ Evelyn Brody opines that exemption is a compromise in which government largely keeps its hands off this “third sovereign” (which is doing things that the “real” sovereign isn’t or can’t – such as religion);¹¹⁴ David Brennan theorizes that exemption should reward diversity in its broadest sense¹¹⁵ and Johnny Rex Buckles finds exemption necessary to avoid taxing “community income.”¹¹⁶ The common thread of all these theories is that none limits exemption and its related tax benefits simply to poor relief. All encompass a vision of charity that extends well beyond such a narrow category; the disagreement is primarily about the exact breadth of exemption.¹¹⁷

Even the one theory that does not explain tax-exemption as a subsidy/incentive for production of goods or services (or ethos) not supplied by the private market or government does not support restricting the exemption to poor relief. This theory, offered by Boris Bittker and George Rahdert bases exemption on the fact that charitable organizations simply do not fit our normative definitions of the tax base and thus are excluded essentially as a matter of administrative convenience.¹¹⁸ But if one adopts this

¹¹³ Rob Atkinson, *Altruism in Nonprofit Organizations*, 31 B.C. L. REV. 501, 617-19 (1990) (proposing that tax exemption in a reward for altruism – the decision to relinquish profits – and that nonprofit organizations can be tax-exempt even if their income funds consumption by people other than those controlling the organization because “[t]he metabenefit of altruistic production” is a desirable policy goal).

¹¹⁴ Evelyn Brody, *Of Sovereignty and Subsidy: Conceptualizing the Charitable Tax Exemption*, 23 J. CORP. L. 585, 585 (1990) (noting that “[f]or all its imprecision, tax exemption keeps government out of the charities’ day-to-day businesses, and keeps charities out of the business of petitioning government for subvention”).

¹¹⁵ David Brennan, *A Diversity Theory of Charitable Tax Exemption: Beyond Efficiency, Through Critical Race Theory, Toward Diversity*, 4 PITTSBURGH TAX REV. 1, 23-24 (2006) (discussing the economic and non-economic benefits of tax exemption for nonprofit organizations and noting that “the charitable tax exemption allows for diversity and experimentation that often lead to production of undiscovered values.”).

¹¹⁶ Johnny Rex Buckles, *The Community Income Theory of the Charitable Contributions Deduction*, 80 IND L. J. 947 (2005)

¹¹⁷ So, for example, Atkinson has an extremely broad conception of the proper role of exemption, extending it to any activity arguably funded in some way by altruism, while the traditional “quid pro quo” approach would limit exemption to activities that otherwise would be paid for by the government. But even the standard “quid pro quo” formula would extend exemption beyond poor relief to other activities a government might undertake in a civil society – education, for example, or public works-type activities such as parks.

¹¹⁸ Boris Bittker and George Rahdert, *The Exemption of Nonprofit Organizations from Federal Income Taxation*, 85 YALE L.J. 299, 307-16 (1976) (discussing how traditional income measurement theory under the IRC cannot be applied to nonprofit organizations and how calculating these organizations’ net income would be difficult and complicated and confusing, and that taxing such income would in effect be a tax on the beneficiaries of the organization who are often too poor to pay tax themselves).

“tax base” explanation for exemption, any organization other than those engaged in regular commercial businesses that fit the normative definitions of “income,” “deductions” and so forth should be exempt; there is no reason, for example, to restrict exemption to disaster relief to the poor; and an organization that builds and maintains a city park used by everyone is just as deserving of exemption under this theory as the Salvation Army.

Finally, the adoption of a view of charity restricted to poor relief essentially is an adoption of one strand of distributive justice without full consideration of the implications of competing strands, or even without considering other potential theoretical measuring sticks, such as economic efficiency or pluralism. Professor Miranda Fleischer has covered this point in depth in a forthcoming article.¹¹⁹ As she notes, existing theoretical scholarship on federal tax exemption (and the corresponding tax benefits, such as deductibility of donations and ability to issue tax-exempt bonds) fails to fully consider the distributive justice issues:

As a result of this desire to avoid value judgments, our theoretical understanding of what projects merit assistance under the charitable tax subsidies is wanting. The traditional subsidy theory demonstrates this most clearly. Although it focuses on the “good” things charities do for society, it contains standards which, standing alone, are too vague to be useful. To say that charities do “good” things that “benefit society” is meaningless without some conception of “the good.” To say that charities should be subsidized because they relieve the government of burdens it would otherwise bear is largely meaningless without some sense of what government should be doing. To say that charities merit subsidy because they provide diverse and creative solutions to societies problems is similarly meaningless

¹¹⁹ Miranda Fleischer, *Theorizing the Charitable Tax Subsidies: The Role of Distributive Justice*, 87 WASH. L. REV. ____ (forthcoming 2009). While other scholars have addressed distributive justice issues in taxation generally (*see, e.g.* William Andrews, *Fairness and the Personal Income Tax: A Reply to Professor Warren*, 88 HARV.L. REV. 947 (1975); Alvin Warren, *Would a Consumption Tax Be Fairer Than an Income Tax?* 89 YALE L. J. 1081 (1980); Barbara H. Fried, *Fairness and the Consumption Tax*, 44 STANFORD L. REV. 961 (1992); Edward J. McCaffery, *A New Understanding of Tax*, 103 MICH. L. REV. 807 (2005)) and have at least raised the point with respect to the charitable tax benefit system (*see, e.g.*, John Simon, Harvey Dale & Laura Chisolm, *The Federal Tax Treatment of Charitable Organizations* 267 in WALTER W. POWELL & RICHARD STEINBERG, EDS., *THE NONPROFIT SECTOR: A RESEARCH HANDBOOK* at 267 (2d. ed. 2006) (noting that one purpose of the charitable tax subsidies is “[t]o bring about ... a degree of fairness or redistribution of resources and opportunities, or at least a discouragement of unacceptable forms of discrimination”)) I have chosen to highlight Professor Fleischer’s work here because it is the most comprehensive treatment of the issue with respect to the charitable tax benefits system that I am aware of. She is, in fact, working on a “sequel” to this piece that will further highlight how specific theories of distributive justice would impact charitable tax benefits.

without a sense of what counts as a problem and which problems should be solved. Lastly, asserting that the altruistic nature of charitable giving merits a subsidy does not answer the question of whether all altruistic acts are equally worthy of a subsidy. The traditional subsidy theories are therefore too vague to adequately identify which projects merit a subsidy.¹²⁰

As an example of her point, Fleischer offers the hypothetical case of a completely-donation-funded ketchup museum.¹²¹ The question for her essentially is “what is it about a ketchup museum, even one funded by donations, that makes anyone think it deserves tax breaks?” In her view, the answer to this question should at least partially come from a rigorous analysis of distributive justice questions raised by giving tax breaks to the ketchup museum (and by implication, not to other potentially “worthy” causes depending on one’s view of the distributive justice issues).

With respect to the question addressed in this paper (e.g., providing tax benefits only, or disproportionately, to charities that redistribute to the poor), Fleischer notes that such a policy implicates a “maxmin” version of welfarism, in which policy should be targeted toward helping the least advantaged in society.¹²² But Fleischer notes that there are many other distributive justice regimes that would produce vastly different results. For example, a version of utilitarianism based on general wealth redistribution would favor any charity that effects a downward distribution of wealth of any kind, not just a distribution to the poor. Hence this version of utilitarianism might justify tax benefits for museums whose patrons are disproportionately middle-class but whose funding comes largely from the rich (and thus might also support middle-class housing in the Hamptons, despite current IRS hostility to that concept).¹²³ On the other hand, such a view would call into question tax breaks for any charity in which the beneficiaries were of similar economic status and hence only minimal wealth redistribution occurred – churches, for example. In contrast, a utilitarian vision that favored happiness over wealth might result in a vastly different tax benefit framework. For example, many empirical studies have

¹²⁰ *Id.* (footnotes omitted) (manuscript page 28).

¹²¹ *Id.* (manuscript at 29). This example originally was proposed by David Schizer at Columbia.

¹²² *Id.* (manuscript at 43-44).

¹²³ *Id.* (manuscript at 40-42).

found a significant correlation between religious activity (church-going) and happiness. This would suggest more tax benefits for churches.¹²⁴ The capability approach to consequentialism championed by Amarta Sen and Martha Nussbaum would provide yet a different answer to the scope of exemption/deduction, as would various strands of egalitarianism.¹²⁵

For purposes of this paper, my point is not to try to argue in favor of one specific version of distributive justice. Rather, the point is that a conception of charity as “poor relief” unwittingly adopts one version of distributive justice (essentially the maxmin version) without adequately considering the implications, particularly the fact that many other theories of distributive justice would support far broader definitions of charity.

IV. Conclusion

A conception of charity for federal tax exemption purposes that is limited to poor relief is contrary to history, to the IRS’s own regulations, and to every theory set forth so far to explain exemption. Such a view also unwittingly adopts a particular formulation of distributive justice without thoroughly examining competing views of distributive justice or even competing theoretical concerns such as economic efficiency.

Nevertheless, the probable explanation for the rise of the redistributionist view is that in a world where charities increasingly resemble for-profit businesses, policy makers need some sort of bright line to distinguish those organizations that have a proper claim to exemption from those that do not. “Helping the poor” is such a long-standing part of the core conception of charity that one can hardly blame policy makers for gravitating toward it as the bright line in question. The bulk of tax theory on exemption and legal philosophy, however, does not support such a narrow view of charity. Nevertheless, until we adopt some coherent rationale for exemption that provides better guidance for determining what activities are eligible for charitable tax benefits, we can expect problems of interpreting the scope of exemption, even at the core, to continue.

¹²⁴ Id. (manuscript at 42).

¹²⁵ Id. (manuscript at 44-48).