
P A R T O N E

**Introduction to the Tax Law
of Charitable Giving**

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C H A P T E R O N E

Charitable Giving Law: Basic Concepts

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

§ 1.1 INTRODUCTION TO THE CHARITABLE CONTRIBUTION DEDUCTION

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

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

The principal charitable contribution deduction is the one that is part of the federal income tax system. A charitable contribution paid during a tax year generally is allowable as a deduction in computing taxable income for federal

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income tax purposes. This deduction is allowable irrespective of either the method of accounting employed or the date on which the contribution may have been pledged.

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

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

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

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

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

¹ See Part Three.

² See Part Four.

³ See Part Six.

⁴ See, e.g., ch. 25.

⁵ Companion books by the author provide a summary of the law concerning tax-exempt organizations as such (*Tax-Exempt Organizations*), planning considerations for tax-exempt organizations (*Planning Guide*), IRS examinations of tax-exempt organizations (*IRS Audits*), and regulation of the charitable fundraising process (*Fundraising*). Governance of tax-exempt organizations is the subject of Hopkins & Gross, *Nonprofit Governance: Law, Practices, & Trends* (Hoboken, NJ: John Wiley & Sons, 2009). These bodies of law are reviewed in less technical detail in Hopkins, *Starting and Managing a Nonprofit Organization: A Legal Guide*, 6th edition (Hoboken, NJ: John Wiley & Sons, 2013). Coverage of these areas of the law (including the charitable giving rules) in even less technical detail is in these books by the author: *Nonprofit Law Made Easy* (Hoboken, NJ: John Wiley & Sons, 2005), *Charitable Giving Law Made Easy* (Hoboken, NJ: John Wiley & Sons, 2007), and *Fundraising Law Made Easy* (Hoboken, NJ: John Wiley & Sons, 2009). All of these areas of the law (and others) are also covered in the *Bruce R. Hopkins' Nonprofit Law Library*, an e-book published by John Wiley & Sons in 2013.

§ 1.2 DEFINING TAX-EXEMPT ORGANIZATIONS

§ 1.2 DEFINING TAX-EXEMPT ORGANIZATIONS

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

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

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

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

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

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

⁸See § 3.3(b), text accompanied by note 303.

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

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

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

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

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

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

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

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

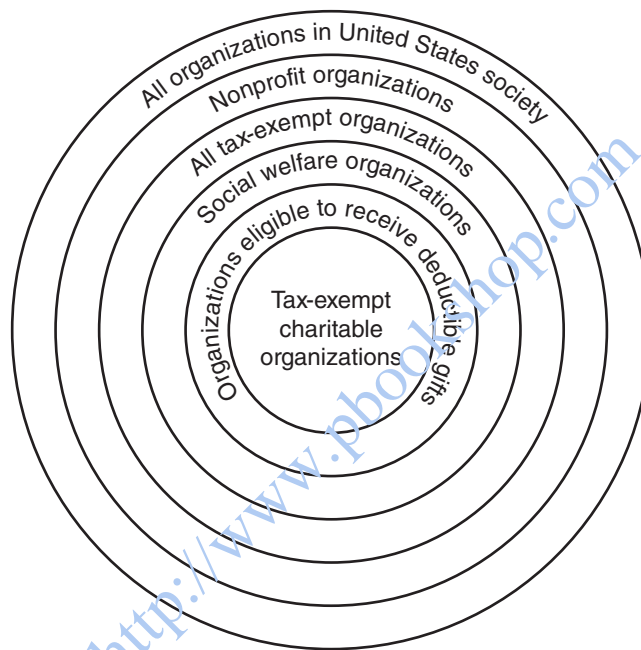
¹² The federal law of tax exemption for charitable organizations requires that each of these entities be organized and operated so that "no part of . . . [its] net earnings . . . inures to the benefit of any private shareholder or individual." IRC § 501(c)(3).

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

As this chapter has indicated thus far, there are subsets and sub-subsets within the nonprofit sector. Tax-exempt organizations are subsets of nonprofit organizations. Charitable organizations (using the broad definition of that term¹⁴) are subsets of tax-exempt organizations. Charitable organizations in the narrow sense are subsets of charitable organizations in the broader sense of that term.¹⁵

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



¹³ IRC §§ 501(c)(9), (17), and (21) (employee benefit trusts), and IRC § 501(c)(7) (social clubs). The various categories of tax-exempt organizations and the accompanying Internal Revenue Code sections are summarized in § 1.5.

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

¹⁵ The complexity of the federal tax law is such that the charitable sector (using the term in its broadest sense) is also divided into two segments: charitable organizations that are considered private (private foundations) and charitable organizations that are considered public (all charitable organizations other than those that are considered private); these nonprivate charities are frequently referred to as public charities. See § 3.4.

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

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

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

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

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any planned legislative scheme” but were enacted over the decades “by a variety of legislators for a variety of reasons.”¹⁶

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

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

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

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

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

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

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

¹⁹ “Comment,” 27 *Iowa L. Rev.* 128, 151–155 (1941).

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

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

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

The sixth rationale for tax-exempt status for nonprofit organizations is predicated on the view that exemption is required to facilitate achievement of an end of significance to the entirety of society. Most organizations that are generally thought of as *charitable* in nature²¹ are entities that are meaningful to the structure and functioning of society in the United States. At least to some degree, this rationale embraces social welfare organizations. This rationale may be termed the *public policy* rationale.²²

(a) Public Policy and National Heritage

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

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

In many cases, though individuals may not do the particular thing so well, on the average, as officers of government, it is nevertheless desirable that it should be done by them, rather than by the government, as a means to their own mental education—a mode of strengthening their active faculties, exercising their judgment, and giving them a familiar knowledge of the subjects with which they are thus left to deal. This is

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

²² See *Tax-Exempt Organizations* § 1.3.

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a principal, though not the sole, recommendation of . . . the conduct of industrial and philanthropic enterprises by voluntary associations.

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

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

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

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

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

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

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

This was the political philosophical climate concerning nonprofit organizations in place when Congress, toward the close of the nineteenth century, began

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considering enactment of an income tax. Although courts would subsequently articulate policy rationales for tax exemption, one of the failures of American jurisprudence is that the Supreme Court and the lower courts have never adequately articulated the public policy doctrine.

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

At the time a constitutional income tax was coming into existence (enacted in 1913²³), Congress legislated in spare language and rarely embellished upon its statutory handiwork with legislative histories. Therefore, there is no contemporary record, in the form of legislative history, of what members of Congress had in mind when they first started creating categories of charitable and other tax-exempt organizations. Congress, it is generally assumed, saw itself doing what other legislative bodies have done over the centuries. One observer stated that the “history of mankind reflects that our early legislators were not setting precedent by exempting religious or charitable organizations” from income tax.²⁴ That is, the political philosophical policy considerations pertaining to nonprofit organizations were such that taxation of these entities—considering their contributions to the well-being and functioning of society—was unthinkable.

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

Some clues are found in the definition of *charitable activities* in the income tax regulations,²⁵ which are thought to reflect congressional intent. The regulations

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

²⁴McGovern, “The Exemption Provisions of Subchapter F,” 29 *Tax Law.* 523, 524 (1976).

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

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refer to purposes such as relief of the poor, advancement of education and science, erection and maintenance of public buildings, and lessening of the burdens of government. These definitions of charitable undertakings clearly derive from the Preamble to the Statute of Charitable Uses,²⁶ written in England in 1601. Reference is there made to certain “charitable” purposes:

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

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

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

The Supreme Court concluded, soon after enactment of the income tax, that the foregoing rationalization was the basis for the federal tax exemption for charitable entities (although in doing so it reflected a degree of uncertainty in the strength of its reasoning, undoubtedly based on the paucity of legislative history). In 1924, the Court stated that “[e]vidently the exemption is made in recognition of the benefit which the public derives from corporate activities of the class named, and is intended to aid them when [they are] not conducted for private gain.”²⁹ Nearly 50 years later, in upholding the constitutionality of income tax exemption for religious organizations, the Court observed that the “State has an affirmative policy that considers these groups as beneficial and stabilizing influences in community life and finds this classification

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

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

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

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

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[tax exemption] useful, desirable, and in the public interest.”³⁰ Subsequently, the Court wrote that, for most categories of nonprofit organizations, “exemption from federal income tax is intended to encourage the provision of services that are deemed socially beneficial.”³¹

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

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

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

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

[A]s to private philanthropy, the promotion of a healthy pluralism is often viewed as a prime social benefit of general significance. In other words, society can be seen as benefiting not only from the application of private wealth to specific purposes in the public interest but also from the variety of choices made by individual philanthropists as to which activities to subsidize. This decentralized choice-making is arguably more efficient and responsive to public needs than the cumbersome and less flexible allocation process of government administration.³⁷

³⁰ *Walz v. Tax Commission*, 397 U.S. 664, 673 (1970).

³¹ *Portland Golf Club v. Commissioner*, 497 U.S. 154, 161 (1990).

³² *Duffy v. Birmingham*, 190 F.2d 738, 740 (8th Cir. 1951).

³³ *Id.*

³⁴ *St. Louis Union Trust Co. v. United States*, 374 F.2d 427, 432 (8th Cir. 1967).

³⁵ *McGlotten v. Connally*, 338 F. Supp. 448, 456 (D.D.C. 1972).

³⁶ *Green v. Connally*, 330 F. Supp. 1150, 1162 (D.D.C. 1971), *aff'd sub nom. Coit v. Green*, 404 U.S. 997 (1971).

³⁷ *Id.*, 330 F. Supp. at 1162.

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

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

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

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

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

Few aspects of American society are more characteristically, more famously American than the nation’s array of voluntary organizations, and the support in both time and money that is given to them by its citizens. Our country has been decisively different in this regard, historian Daniel Boorstin observes, “from the beginning.” As the country was settled, “communities existed before governments were there to care for public needs.” The result, Boorstin says, was that “voluntary collaborative activities” were set up to provide basic social services. Government followed later.

The practice of attending to community needs outside of government has profoundly shaped American society and its institutional framework. While in most other countries, major social institutions such as universities, hospitals, schools, libraries, museums and social welfare agencies are state-run and state-funded, in the United States many of the same organizations are privately controlled and voluntarily supported. The institutional landscape of America is, in fact, teeming with non-governmental, noncommercial organizations, all the way from some of the world’s

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

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

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leading educational and cultural institutions to local garden clubs, from politically powerful national associations to block associations—literally millions of groups in all. This vast and varied array is, and has long been widely recognized as, part of the very fabric of American life. It reflects a national belief in the philosophy of pluralism and in the profound importance to society of individual initiative.

Underpinning the virtual omnipresence of voluntary organizations, and a form of individual initiative in its own right, is the practice—in the case of many Americans, the deeply ingrained habit—of philanthropy, of private giving, which provides the resource base for voluntary organizations.

These two interrelated elements, then, are sizable forces in American society, far larger than in any other country. And they have contributed immeasurably to this country's social and scientific progress. On the ledger of recent contributions are such diverse advances as the creation of noncommercial "public" television, the development of environmental, consumerist and demographic consciousness, community-oriented museum programs, the protecting of land and landmarks from the often heedless rush of "progress." The list is endless and still growing; both the number and deeds of voluntary organizations are increasing. "Americans are forever forming associations," wrote de Tocqueville. They still are: tens of thousands of environmental organizations have sprung up in the last few years alone. Private giving is growing, too, at least in current dollar amounts.⁴⁰

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

is the very possibility of doing something different than government can do, of creating an institution free to make choices government cannot—even seemingly arbitrary ones—without having to provide a justification that will be examined in a court of law, which stimulates much private giving and interest.⁴¹

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

Voluntarism has been responsible for the creation and maintenance of churches, schools, colleges, universities, laboratories, hospitals, libraries, museums, and the performing arts; voluntarism has given rise to the public and private health and welfare systems and many other functions and services that are now an integral part

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

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

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of the American civilization. In no other country has private philanthropy become so vital a part of the national culture or so effective an instrument in prodding government to closer attention to social needs.⁴²

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

It is not possible, in a book of this nature, to fully capture the philosophical underpinnings of the nonprofit sector. This task has been accomplished, however, by Brian O'Connell while president of Independent Sector.⁴⁷ In a foreword to Mr. O'Connell's work, John W. Gardner stated this basic truth: "All Americans interact with voluntary or nonprofit agencies and activities regularly, although they are often unaware of this fact."⁴⁸ Still, the educational process must continue, for, as Mr. Gardner wrote, "The sector enhances our creativity, enlivens our communities, nurtures individual responsibility, stirs life at the grassroots, and reminds us that we were born free."⁴⁹ Mr. O'Connell's collection includes thoughts from sources as diverse as Max Lerner ("the associative impulse is strong in American life; no other civilization can show as many secret fraternal orders, businessmen's 'service clubs,' trade and occupational associations, social clubs, garden clubs, women's clubs, church clubs, theater groups, political and reform associations, veterans' groups, ethnic societies, and other clusterings of trivial or substantial importance"⁵⁰);

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

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

⁴⁴ *Id.* at 17.

⁴⁵ *Id.* at 18.

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

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

⁴⁸ *Id.* at xi.

⁴⁹ *Id.* at xv.

⁵⁰ *Id.* at 81.

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Daniel J. Boorstin (“in America, even in modern times, communities existed before governments were there to care for public needs”⁵¹); Merle Curti (“voluntary association with others in common causes has been thought to be strikingly characteristic of American life”⁵²); John W. Gardner (“For many countries . . . monolithic central support of all educational, scientific, and charitable activities would be regarded as normal . . . [b]ut for the United States it would mean the end of a great tradition”⁵³); Richard C. Cornuelle (“We have been unique because another sector, clearly distinct from the other two, has, in the past, borne a heavy load of public responsibility”⁵⁴); John D. Rockefeller III (“The third sector is . . . the seedbed for organized efforts to deal with social problems”⁵⁵); Waldemar A. Neilsen (“the ultimate contribution of the Third Sector to our national life—namely what it does to ensure the continuing responsiveness, creativity and self-renewal of our democratic society”⁵⁶); Richard W. Lyman (“an array of its [the independent sector’s] virtues that is by now fairly familiar: its contributions to pluralism and diversity, its tendency to enable individuals to participate in civic life in ways that make sense to them and help to combat that corrosive feeling of powerlessness that is among the dread social diseases of our era, its encouragement of innovation and its capacity to act as a check on the inadequacies of government”⁵⁷); and Mr. O’Connell himself (“The problems of contemporary society are more complex, the solutions more involved and the satisfactions more obscure, but the basic ingredients are still the caring and the resolve to make things better”).⁵⁸

Consequently, it is erroneous to regard the charitable contribution deduction and tax exemption as anything other than a reflection of this larger doctrine. Congress is not merely “giving” eligible nonprofit organizations any “benefits”; the charitable deduction or exemption from taxation is not a “loophole,” a “preference,” or a “subsidy”—it is not really an “indirect appropriation.”⁵⁹ Rather, the various Internal Revenue Code provisions that establish the

⁵¹ *Id.* at 131.

⁵² *Id.* at 162.

⁵³ *Id.* at 256.

⁵⁴ *Id.* at 278.

⁵⁵ *Id.* at 356.

⁵⁶ *Id.* at 368.

⁵⁷ *Id.* at 371.

⁵⁸ *Id.* at 408. A companion book by the author addresses this point in additional detail and traces the origins and development of a hypothetical charitable organization to illustrate the applicability of various federal and state laws concerning nonprofit organizations. See *Starting and Managing a Nonprofit Organization: A Legal Guide*, 6th ed. (Hoboken, NJ: John Wiley & Sons, 2013).

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

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tax exemption system exist as a reflection of the affirmative policy of American government to refrain from inhibiting by taxation the beneficial activities of qualified tax-exempt organizations acting in community and other public interests.⁶⁰

(b) Other Rationales

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

The tax exemption for fraternal beneficiary organizations also depends, at least in part, on this defense. A study of the insurance practices of large societies by the Department of the Treasury⁶³ concluded that this rationale is inapplicable with respect to the insurance programs of these entities because the "provision of life insurance and other benefits is generally not considered a good or service with significant external benefits" to society generally. The report stated, however, that "tax exemption for these goods and services [insurance and like benefits] may be justified in order to encourage" the charitable activities conducted by these organizations. The inherent tax rationale⁶⁴ "may" provide a basis for tax exemption for "certain" of these societies' services, according to the report. Further, the report observed that "[i]nsurance is not a type of product for

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

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

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

⁶² See *id.* § 16.1.

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

⁶⁴ See *supra* note 60.

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which consumers may lack access to information on the appropriate quantity or quality that they need.” Therefore, the market failure rationale⁶⁵ “may not be applicable” in this instance.

Other federal tax exemption provisions may be traced to an effort to achieve a particular objective. These provisions tend to be of more recent vintage, testimony to the fact of a more complex Internal Revenue Code. For example, specific tax exemption for veterans’ organizations⁶⁶ was enacted to create a category of organizations entitled to use a particular exemption from the unrelated business income tax,⁶⁷ and statutory exemption for homeowners’ associations⁶⁸ came about because of a shift in the policy of the Internal Revenue Service (IRS) regarding the scope of tax exemption provided for social welfare organizations. The tax exemption for college and university investment vehicles was the result of Congress’s effort to preserve the exempt status of a specific common investment fund in the face of an IRS determination to the contrary.⁶⁹ As is so often the case with respect to the tax law generally, a particular tax exemption provision can arise as the result of case law, or to clarify it; this was the origin of statutes granting tax exemption to cooperative hospital service organizations,⁷⁰ charitable risk pools,⁷¹ child care organizations,⁷² public safety testing entities,⁷³ and qualified tuition programs.⁷⁴

All of the foregoing rationales for tax-exempt organizations have been described in philosophical, historical, political, policy, or technical tax terms. Yet another approach to an understanding of exempt organizations can be found in economic theory.

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

According to the demand-side analysis, consumers in many contexts prefer to deal with nonprofit, tax-exempt, usually charitable organizations in purchasing goods and services, because the consumer knows that a nonprofit

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

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

⁶⁷ See *id.* § 24.10, text accompanied by note 947.

⁶⁸ See *id.* § 19.14.

⁶⁹ See *id.* § 11.5.

⁷⁰ See *id.* § 11.4.

⁷¹ See *id.* § 11.6.

⁷² See *id.* § 8.8.

⁷³ See *id.* § 11.3.

⁷⁴ See *id.* § 19.17.

⁷⁵ Hansmann, “The Role of Nonprofit Enterprise,” 89 *Yale L.J.* 835, 896 (1980).

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

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

Although the economic demand-side theory is fascinating and undoubtedly contains much truth, it probably overstates the aspect of consumer demand and downplays historical realities, tax considerations, and human frailties. The nonprofit organization antedates the for-profit corporation, and many of today’s tax-exempt organizations may be nonprofit because their forebears started out as such. In addition, the forces of pluralism of institutions and organizations continue to shape much of the contemporary independent sector.

(c) Freedom of Association

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

By application of the doctrine of freedom of intimate association, the formation and preservation of certain types of highly personal relationships

⁷⁶ *Id.* at 844.

⁷⁷ *Id.* at 847.

⁷⁸ *Id.* at 845.

⁷⁹ *Id.* at 843.

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

The freedom to engage in group effort is guaranteed under the doctrine of freedom of expressive association⁸⁴ and is viewed as a way of advancing political, social, economic, educational, religious, and cultural ends.⁸⁵ Government, however, has the ability to infringe on this right when compelling state interests are served that are unrelated to the suppression of ideas and that cannot be achieved through means significantly less restrictive of associational freedoms.⁸⁶

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

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

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

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

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

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

⁸⁵ *Boy Scouts of America et al. v. Dale*, 530 U.S. 640 (2000); *NAACP v. Claiborne Hardware Co.*, 458 U.S. 886 (1982); *Larson v. Valente*, 456 U.S. 228 (1982); *In re Primus*, 436 U.S. 412 (1978); *Abood v. Detroit Bd. of Educ.*, 431 U.S. 209 (1977).

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

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

⁸⁸ *Id.* at 622–629.

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discrimination would be to deny “society the benefits of wide participation in political, economic, and cultural life.”⁸⁹

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

Over the years, there have been many efforts to analyze and portray the nonprofit sector. One of the first of these significant undertakings, utilizing statistics, conducted jointly by the Survey Research Center at the University of Michigan and the U.S. Census Bureau, was published in 1975 as part of the findings of the Commission on Private Philanthropy and Public Needs.⁹¹ The data compiled for the commission’s use were for 1973. Contemporary charitable giving statistics are explored in the following, but one striking basis of comparison cannot be resisted at this point. Charitable giving in that year was \$26 billion, while for 2012 the amount was more than \$316 billion.⁹²

Research of this nature developed for the commission spawned recurring statistical portraits of the sector. One of the most comprehensive of these analyses is that provided in the periodic almanac published by the Urban Institute.⁹³ Others include a fascinating portrait of the “third America”⁹⁴ and the annual survey of charitable giving published by the Giving USA Foundation.⁹⁵

⁸⁹ *Id.* at 625. In general, see *Tax-Exempt Organizations* § 1.7; Hopkins, *Tax-Exempt Organizations and Constitutional Law: Nonprofit Law as Shaped by the U.S. Supreme Court* (Hoboken, NJ: John Wiley & Sons, 2012) § 1.9; Brody, “Entrance, Voice, and Exit: The Constitutional Bounds of the Right of Association,” 35 *U.C. Davis L. Rev.* (no. 4) 821 (April 2002); Linder, “Freedom of Association after *Roberts v. United States Jaycees*,” 82 *Mich. L. Rev.* (no. 8) 1878 (1984).

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

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

⁹² See text accompanied by *infra* note 120.

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

⁹⁴ *Nonprofit Nation*.

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

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The IRS's Statistics of Income Division collects data on tax-exempt organizations.⁹⁶ Further, various subsets of the nonprofit sector are the subject of specific portrayals.⁹⁷

The nonprofit sector in the United States is not uniformly labeled; it goes by many names. In addition to *nonprofit*, adjectives used include *tax-exempt*, *voluntary*, *nongovernmental*, *independent*, and *voluntary*.⁹⁸ (In the author's view, *nonprofit sector* endures as the sturdiest of the terms.) In its most expansive definition, the nonprofit sector comprises all tax-exempt organizations and some entities that cannot qualify for exemption. The Independent Sector organization defined the *independent sector* as all charitable⁹⁹ and social welfare organizations.¹⁰⁰

As Independent Sector defined the sector, it is comprised of "many, varied" organizations, such as "religious organizations, private colleges and schools, foundations, hospitals, day care centers, environmental organizations, museums, symphony orchestras, youth organizations, advocacy groups, and neighborhood organizations, to name a few." This analysis continued: "What is common among them all is their mission to serve a public purpose, their voluntary and self-governing nature, and their exclusion from being able to distribute profits to stockholders."¹⁰¹

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

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

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

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

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

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

¹⁰¹ *Nonprofit Almanac* (2002) at 3.

¹⁰² *Nonprofit Nation* at 8.

¹⁰³ *Id.* at 1.

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In an understatement, the observation was made that “[m]easuring the number of organizations in the independent sector is a complex activity, largely because of the diversity of its components.”¹⁰⁴ There are several reasons for this. One reason is that church organizations (of which there are an estimated 350,000¹⁰⁵) are not required to file annual information returns with the IRS,¹⁰⁶ so data concerning them is difficult to amass. Also, hundreds of organizations fall under a group exemption¹⁰⁷ and thus are not separately identified. Further, smaller nonprofit organizations need not seek recognition of tax exemption from the IRS.¹⁰⁸ Small organizations are not required to file annual information returns with the IRS but are required to electronically file a short notice as to their existence.¹⁰⁹

The number of tax-exempt organizations that are formally recognized in the federal tax law context is approaching 2 million. The most recent analysis posited the number of exempt organizations registered with the IRS (based on 2005 data) at about 1.4 million.¹¹⁰ This analysis also stated that 528,024 exempt organizations report to the IRS.¹¹¹

Because a “price cannot be placed on the output of most nonprofit organizations,” their percentage of the gross domestic product is difficult to assess; the best estimate is that it is about 5 percent.¹¹² When the measure is in terms of wages and salaries paid, the percentage rises to approximately 8 percent.¹¹³ Other ways to measure the size of the sector are its revenue (about \$1,006.7 billion in 2006),¹¹⁴ its outlays (about \$915.2 billion in 2005),¹¹⁵ and its paid employment (12.9 million individuals in 2005).¹¹⁶ Most of the sector’s revenue is in the form of fees for services provided, followed by contributions and grants.¹¹⁷ As to outlays (2006 data), the funds are expended by the organizations

¹⁰⁴ *Id.* at 8. The point was articulated more forcefully in the fifth edition (1996) of the *Nonprofit Almanac*, where it was stated that “[c]ounting the number of institutions in the independent sector is a challenge.” *Nonprofit Almanac* at 25.

¹⁰⁵ *Nonprofit Almanac* at 139. The term *church* includes analogous religious congregations, such as temples and mosques. See *Tax-Exempt Organizations* § 10.3.

¹⁰⁶ See *Tax-Exempt Organizations* § 27.2(b)(i).

¹⁰⁷ See *Tax-Exempt Organizations* § 25.6.

¹⁰⁸ These are organizations that normally do not generate more than \$5,000 in revenue. See *Tax-Exempt Organizations* § 27.2(b)(ii).

¹⁰⁹ See *Tax-Exempt Organizations* § 27.3.

¹¹⁰ *Nonprofit Almanac* at 3, 140.

¹¹¹ *Id.* at 3.

¹¹² *Id.* at 9.

¹¹³ *Id.* at 10.

¹¹⁴ *Id.* at 115.

¹¹⁵ *Id.*

¹¹⁶ *Id.* at 18, 27.

¹¹⁷ *Id.* at 115. Fees for services and goods were estimated to be 70.3 percent of the total; contributions and nongovernment grants were said to be 12.3 percent of the total (*id.* at 143–144).

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(88.7 percent), granted (8 percent), or invested or used as a buffer for cash flow (3.3 percent).¹¹⁸

The most recent statistics published by the IRS in this area are for tax year 2009.¹¹⁹ This data states that 320,791 public charities filed annual information returns for that year. These organizations held \$2.7 trillion in assets and received \$1.48 trillion in revenue. Nearly three-fourths of this revenue (\$1.09 trillion) was derived from the conduct of program services.

Charitable giving in the United States in 2012 is estimated to have totaled \$316.23 billion.¹²⁰ Giving by individuals in 2012 amounted to an estimated \$228.93 billion; this level of giving constituted 72 percent of all charitable giving for the year. Grant making by private foundations is an estimated \$45.74 billion (15 percent of total funding). Gifts in the form of charitable bequests in 2012 are estimated to be \$23.41 billion (7 percent of total giving). Gifts from corporations in 2012 totaled \$18.15 billion (6 percent of total giving for that year).

Contributions to religious organizations in 2012 totaled \$101.54 billion (32 percent of all giving that year). Gifts to educational organizations amounted to \$41.33 billion (13 percent); to human service entities, \$40.4 billion (13 percent); to foundations, \$30.58 billion (9 percent); to health care institutions, \$28.12 billion (9 percent); to public-society benefit organizations, \$21.63 billion (7 percent); to international affairs entities, \$19.11 billion (6 percent); to arts, culture, and humanities entities, \$14.44 billion (5 percent); and to environment and animals groups, \$8.3 billion (3 percent). Approximately \$6.82 billion (2 percent) was unallocated.

For 2010, 22.5 million individual taxpayers who itemized deductions reported \$44.3 billion in deductions for noncash charitable contributions.¹²¹ Of these taxpayers, 7.3 million reported \$34.9 billion in deductions for charitable gifts on Form 8283.¹²² The number of taxpayers filing Form 8283 increased by 9.1 percent from 6.7 million for 2009; the amount claimed for donations increased by 24.7 percent, from \$28 billion in 2009.

Contributions of corporate stock represented the largest share of total gifts, in terms of amounts claimed. For 2010, corporate stock donations were \$13.4 billion, which represented 38.3 percent of all donations claimed. Gifts of clothing (\$8.3 billion) amounted to 23.8 percent of the gifts; household items (\$3.3 billion) accounted for 9.3 percent. The remaining gift categories were

¹¹⁸ *Id.* at 121.

¹¹⁹ Arnsberger, "Nonprofit Charitable Organizations, 2009," 32 *Statistics of Income Bulletin* (no. 2) 169 (Fall 2012).

¹²⁰ These data are from *Giving USA 2013*, published by the Giving USA Foundation, and researched and written by the Center on Philanthropy at Indiana University.

¹²¹ Liddell & Wilson, "Individual Noncash Contributions, 2010," 32 *Statistics of Income Bulletin* (no. 3) 64 (Winter 2013).

¹²² See § 24.7(a), App. C.

§ 1.4 STATISTICAL PROFILE OF CHARITABLE SECTOR

relatively small, such as art and collectibles (3 percent), real estate (2.2 percent), easements (2.2 percent), and automobiles (0.8 percent).

Most of these contributions were made to large organizations (\$8.9 billion) and foundations (\$8.7 billion). These two categories of gifts represented a little over one-half of the gifts. The largest average contribution (\$97,552 per return) was made to foundations; the second largest (\$86,981 per return) was made to donor-advised funds.

Here are some other perspectives on the nonprofit sector:

- It has more civilian employees than the federal government and the 50 state governments combined.
- It employs more people than any of the following industries: agriculture; mining; construction; transportation, communications, and other public utilities; and finance, insurance, and real estate.
- It generates revenue that exceeds the gross domestic product of all but six foreign countries: China, France, Germany, Italy, Japan, and the United Kingdom.¹²³

Statistics, of course, cannot provide the entire nonprofit sector picture. As the Commission on Private Philanthropy and Public Needs observed (albeit 35 years ago), the “arithmetic of the nonprofit sector finds much of its significance in less quantifiable and even less precise dimensions—in the human measurements of who is served, who is affected by nonprofit groups and activities.” The Commission added:

In some sense, everybody is [served or affected by the sector]: the contributions of voluntary organizations to broadscale social and scientific advances have been widely and frequently extolled. Charitable groups were in the forefront of ridding society of child labor; abolitionist groups in tearing down the institution of slavery, civic-minded groups in purging the spoils system from public office. The benefits of non-profit scientific and technological research include the great reduction of scourges such as tuberculosis and polio, malaria, typhus, influenza, rabies, yaws, bilharziasis, syphilis and amoebic dysentery. These are among the myriad products of the nonprofit sector that have at least indirectly affected all Americans and much of the rest of the world besides.

Perhaps the nonprofit activity that most directly touches the lives of most Americans today is noncommercial “public” television. A bare concept twenty-five years ago, its development was underwritten mainly by foundations. Today it comprises a network of some 240 stations valued at billions of dollars, is increasingly supported by small, “subscriber” contributions and has broadened and enriched a medium that occupies hours of the average American’s day.

¹²³ *Nonprofit Nation* at 12.

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More particularly benefited by voluntary organizations are the one-quarter of all college and university students who attend private institutions of higher education. For hundreds of millions of Americans, private community hospitals, accounting for half of all hospitals in the United States, have been, as one Commission study puts it, “the primary site for handling the most dramatic of human experiences—birth, death, and the alleviation of personal suffering.” In this secular age, too, it is worth noting that the largest category in the nonprofit sector is still very large indeed; nearly two out of three Americans belong to and evidently find comfort and inspiration in the nation’s hundreds of thousands of religious organizations. All told, it would be hard to imagine American life without voluntary nonprofit organizations and associations, so entwined are they in the very fabric of our society, from massive national organizations to the local Girl Scouts, the parent-teacher association, or the bottle recycling group.¹²⁴

§ 1.5 CATEGORIES OF TAX-EXEMPT ORGANIZATIONS

Understanding of and perspective on the charitable sector, from a law and statistics standpoint, may be enhanced by placement of it in the entirety of the tax-exempt sector.

The breakdown of these tax-exempt organizations is as follows:¹²⁵ 100 instrumentalities of the United States,¹²⁶ 5,850 single-parent title-holding companies,¹²⁷ 984,386 charitable organizations,¹²⁸ 116,890 social welfare organizations,¹²⁹ 56,819 labor and agricultural organizations,¹³⁰ 71,878 business leagues,¹³¹ 56,369 social and recreational clubs,¹³² 63,318 fraternal beneficiary societies,¹³³ 10,088 voluntary employees’ beneficiary societies,¹³⁴ 20,944 domestic fraternal beneficiary societies,¹³⁵ 14 teachers’ retirement funds,¹³⁶ 5,901 benevolent life insurance associations,¹³⁷ 9,808 cemetery companies,¹³⁸ 3,565

¹²⁴ *Report of the Commission on Private Philanthropy and Public Needs: Giving in America—Toward a Stronger Voluntary Sector* at 34–48 (1975).

¹²⁵ *Nonprofit Almanac* at 2–3.

¹²⁶ Organizations described in IRC § 501(c)(1) (see *Tax-Exempt Organizations* § 19.1).

¹²⁷ Organizations described in IRC § 501(c)(2) (see *Tax-Exempt Organizations* § 19.2(a)).

¹²⁸ Organizations described in IRC § 501(c)(3) (see *Tax-Exempt Organizations* pt. 2). The entities referenced in notes 146–152 of this book are also charitable organizations.

¹²⁹ Organizations described in IRC § 501(c)(4) (see *Tax-Exempt Organizations* ch. 13).

¹³⁰ Organizations described in IRC § 501(c)(5) (see *Tax-Exempt Organizations* ch. 16).

¹³¹ Organizations described in IRC § 501(c)(6) (see *Tax-Exempt Organizations* ch. 14).

¹³² Organizations described in IRC § 501(c)(7) (see *Tax-Exempt Organizations* ch. 15).

¹³³ Organizations described in IRC § 501(c)(8) (see *Tax-Exempt Organizations* § 19.4(a)).

¹³⁴ Organizations described in IRC § 501(c)(9) (see *Tax-Exempt Organizations* § 18.3).

¹³⁵ Organizations described in IRC § 501(c)(10) (see *Tax-Exempt Organizations* § 19.4(b)).

¹³⁶ Organizations described in IRC § 501(c)(11) (see *Tax-Exempt Organizations* § 18.6).

¹³⁷ Organizations described in IRC § 501(c)(12) (see *Tax-Exempt Organizations* § 19.5).

¹³⁸ Organizations described in IRC § 501(c)(13) (see *Tax-Exempt Organizations* § 19.6).

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credit unions,¹³⁹ 1,646 mutual insurance companies,¹⁴⁰ 16 crop operations finance corporations,¹⁴¹ 300 supplemental unemployment benefit trusts,¹⁴² 1 employee-funded pension trust,¹⁴³ 35,113 war veterans' organizations,¹⁴⁴ 9 group legal services organizations,¹⁴⁵ 28 black lung benefit trusts,¹⁴⁶ 2 veterans' organizations founded prior to 1880,¹⁴⁷ 1 trust described in section 4049 of the Employee Retirement Income Security Act,¹⁴⁸ 1,133 title-holding companies for multiple beneficiaries,¹⁴⁹ 10 organizations providing medical insurance for those difficult to insure,¹⁵⁰ 12 state-formed workers' compensation organizations,¹⁵¹ 160 religious and apostolic organizations,¹⁵² 18 cooperative hospital service organizations,¹⁵³ and 1 cooperative service organization of educational institutions.¹⁵⁴

This enumeration of tax-exempt organizations does not include references to farmers' cooperatives,¹⁵⁵ political organizations,¹⁵⁶ homeowners' associations,¹⁵⁷ multiemployer pension trusts,¹⁵⁸ day care centers,¹⁵⁹ shipowners' protection and indemnity organizations,¹⁶⁰ or charitable risk pools.¹⁶¹

The federal tax law recognizes 68 categories of tax-exempt organizations.¹⁶²

¹³⁹ Organizations described in IRC § 501(c)(14) (see *Tax-Exempt Organizations* § 19.7).

¹⁴⁰ Organizations described in IRC § 501(c)(15) (see *Tax-Exempt Organizations* § 19.9).

¹⁴¹ Organizations described in IRC § 501(c)(16) (see *Tax-Exempt Organizations* § 19.10).

¹⁴² Organizations described in IRC § 501(c)(17) (see *Tax-Exempt Organizations* § 18.4).

¹⁴³ Organizations described in IRC § 501(c)(18) (see *Tax-Exempt Organizations* § 18.6).

¹⁴⁴ Organizations described in IRC § 501(c)(19) (see *Tax-Exempt Organizations* § 19.11(a)).

¹⁴⁵ Organizations that were described in IRC § 501(c)(20), prior to its expiration in 1992.

¹⁴⁶ Organizations described in IRC § 501(c)(21) (see *Tax-Exempt Organizations* § 18.5).

¹⁴⁷ Organizations described in IRC § 501(c)(23) (see *Tax-Exempt Organizations* § 19.11(b)).

¹⁴⁸ Organizations described in IRC § 501(c)(24) (see *Tax-Exempt Organizations* § 18.6).

¹⁴⁹ Organizations described in IRC § 501(c)(25) (see *Tax-Exempt Organizations* § 19.2(b)).

¹⁵⁰ Organizations described in IRC § 501(c)(26) (see *Tax-Exempt Organizations* § 19.15).

¹⁵¹ Organizations described in IRC § 501(c)(27) (see *Tax-Exempt Organizations* § 19.16).

¹⁵² Organizations described in IRC § 501(d) (see *Tax-Exempt Organizations* § 10.7).

¹⁵³ Organizations described in IRC § 501(e) (see *Tax-Exempt Organizations* § 11.4).

¹⁵⁴ Organizations described in IRC § 501(f) (see *Tax-Exempt Organizations* § 11.5).

¹⁵⁵ Organizations described in IRC § 521 (see *Tax-Exempt Organizations* § 19.12).

¹⁵⁶ Organizations described in IRC § 527 (see *Tax-Exempt Organizations* ch. 17).

¹⁵⁷ Organizations described in IRC § 528 (see *Tax-Exempt Organizations* § 19.14).

¹⁵⁸ Organizations described in IRC § 501(c)(22) (see *Tax-Exempt Organizations* § 18.6).

¹⁵⁹ Organizations described in IRC § 501(k) (see *Tax-Exempt Organizations* § 8.8).

¹⁶⁰ Organizations described in IRC § 526(d) (see *Tax-Exempt Organizations* § 19.13).

¹⁶¹ Organizations described in IRC § 501(n) (see *Tax-Exempt Organizations* § 11.6). The *Nonprofit Almanac* stated that there are 4,105 tax-exempt organizations other than those specifically enumerated (at 3). As the preceding footnotes indicate, the many categories of tax-exempt organizations are discussed in various chapters throughout *Tax-Exempt Organizations*. Nonetheless, as the following observation by the U.S. Tax Court affirms, "[t]rying to understand the various exempt organization provisions of the Internal Revenue Code is as difficult as capturing a drop of mercury under your thumb." *Weingarden v. Commissioner*, 86 T.C. 669, 675 (1986), *rev'd on other grounds*, 825 F.2d 1027 (6th Cir. 1987).

¹⁶² See *Tax-Exempt Organizations* app. C.

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