

# Federalization of the Law of Charity

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*To this day, the law of charity is often thought of as a matter for the states. In fact, the crucial law relating to charity is now almost always federal. For certain purposes, state law still determines whether a given entity is “charitable.” It also determines the propriety of a charitable fiduciary’s conduct when someone who has standing sues. But federal law determines whether an entity qualifies for various tax incentives, such as exemption from the federal income tax and eligibility to receive tax-deductible gifts, and qualification for these incentives generally determines whether the entity comes into existence and, if so, whether it survives. Federal law also wields a bewildering array of draconian penalties against both charities and their fiduciaries for failure to comply with federally specified rules of behavior. This Article examines both of these and other ways in which federal law has essentially taken over the law of charity. The point is not whether federalization of the law of charity is good or bad. The point is simply this: During the last century, Congress and the federal courts federalized the law of charity.*

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## I. INTRODUCTION

The law of charity has long been thought of as a matter for the states. Indeed, until early in the last century, when the federal government enacted the income, gift, and estate taxes, the law of charity was an exclusively state concern. Federalization of the law of charity has now proceeded to such an extent, however, that it eclipses state law. Whether from a conceptual, organizational, or operational perspective, the crucial law relating to charity is now almost always federal.

State law still determines whether a given entity is “charitable,” but federal law determines whether an entity qualifies for various tax incentives, such as exemption from the federal income tax and eligibility to receive tax-deductible gifts, and qualification for these incentives generally determines whether the entity comes into existence and, if so, whether it survives. State law continues to determine the propriety of a charitable fiduciary’s conduct; indeed, on those rather rare occasions when someone sufficiently interested in enforcing a charitable fiduciary’s duties is found to have standing, state law remains ascendant. On the other hand, federal law not only specifies in great detail how a charity that wants to become and remain eligible for federal tax incentives must behave, it also wields a bewildering array of often draconian penalties against both charities and their fiduciaries for failure to toe the federally specified lines. Certainly, the federal rules do not always coincide with the parallel state-law rules; nor does Congress seem to have intended them to. State law continues to permit the creation of various and sundry devices for the benefit of charity, but because under federal law only a favored few qualify their donors for the charitable deduction, no competent counselor would ever recommend anything else. Notwithstanding the fact that federal tax law has dramatically shrunk the universe of rational choices by which to benefit charity, the use of trusts to benefit charity seems to have increased dramatically—and the increase seems in no small part attributable to federal tax incentives. Yet the uniqueness of the approved federal devices and the detailed federal requirements that accompany them indisputably strain the state-law system that usually ends up interpreting and enforcing the governing instruments. Nowhere is this clearer than in

the case of charitable conservation easements. And these are only some of the many ways in which federal law is dramatically reshaping the law of charity. Thus, while the law of charity, as developed and maintained by the states, remains relevant in many and sometimes vital ways, most of the charity-related law that really matters these days is federal.

Whether federalization of the law of charity is good or bad is not the point. As is true of most things, one might rightly observe that it is both. There seems to be virtual consensus that in most states, enforcement of charity and the obligations of charitable fiduciaries has long been essentially nonexistent. Given the states' massive failure in this regard, it seems hard to argue that a federal intrusion or virtual takeover of the field serves no legitimate purpose, or that it is consequentially inconsistent with state law. And yet federalization of the law of charity most certainly has been and continues to be both ham-fisted and overly complex. Nor is the objective to conjure up a vast federal conspiracy to wrest the law of charity from the states. The process was instead almost surely just a logical consequence of the twin congressional decisions to impose income, estate, and gift taxes, and to grant charity immensely privileged statuses under each. Once Congress thus got its nose under the tent flap, it eventually came to understand that, given most states' failure to police the behavior of charities and their fiduciaries, it was paying dearly with tax dollars for charity that often never happened. No later than with the Tax Reform Act of 1969, in which Congress imposed both the excise taxes on private foundations and the split-interest rules, Congress undeniably began to chart a course of policing charities and their fiduciaries, explicitly and on a national basis. The point here, however, is considerably simpler. Something very important happened during the last century. The federal government basically took over the law of charity.

## II. WHAT IS "CHARITABLE"?

Whether a particular purpose or entity qualifies as "charitable" has long been, and continues to be, a matter of state law. Copious amounts of state law, both statutory and judicial, make this clear.<sup>1</sup> Neither the legislation nor the cases have tapered off. State law remains relevant in a variety of ways, including whether a particular

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1. See generally 6 AUSTIN WAKEMAN SCOTT, WILLIAM FRANKLIN FRATCHER & MARK L. ASCHER, SCOTT AND ASCHER ON TRUSTS ch. 38 (5th ed. 2009) (providing a comprehensive overview of charitable purposes as defined across time and jurisdiction).

corporation qualifies under state law as a not-for-profit, whether a particular entity qualifies for state or local tax exemptions, and whether, upon failure of the entity's original purpose, cy pres is available to salvage the entity's existence.<sup>2</sup> There is no risk that state law relating to what constitutes charity will become irrelevant anytime soon.

On the other hand, these days, it's federal law that really matters insofar as what's charitable. It's all fine and good to be a philanthropist, but few, if any, major donors knowingly make charitable transfers for which they will receive no deduction for income tax purposes, let alone for which they will generate a transfer tax, either during life or at death. So anyone involved in the planning of a major gift to charity, or, for that matter, the conception of a new charity or the operation of an already existing charity, is or should be keenly concerned with whether the charity in question qualifies to receive transfers that are deductible for income and gift or estate tax purposes. This is almost entirely a matter of federal law.<sup>3</sup> Similarly, anyone creating or operating a charity is or should be keenly aware of the need to ensure that the entity's income not be subjected to the federal income tax. This, too, is a matter that is almost exclusively federal.<sup>4</sup> Indeed, the regulations require that language in a section 501(c)(3) charity's governing instrument limit its purposes to one or more of those described in the *federal* statute.<sup>5</sup>

Nor are the differences between state and federal law always trivial. To be federally exempt, section 501(c)(3), the primary provision relating to what has traditionally passed for charity, requires a charity to be

organized and operated exclusively for religious, charitable, scientific, testing for public safety, literary, or educational purposes, or to foster national or international amateur sports competition . . . or for the prevention of cruelty to children or animals, no part of the net earnings of which inures to the benefit of any private shareholder or individual, no substantial part of the activities of which is carrying on propaganda, or otherwise attempting, to influence legislation . . . and which does not participate in, or intervene in

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2. See, e.g., 5 *id.* §§ 37.1.1, 37.1.4, 37.4.2.2 (5th ed. 2008) (discussing qualifications for nonprofit incorporation, requirements for tax-exempt status, and availability of cy pres).

3. See I.R.C. § 170(a), (c) (2012) (providing for deductibility of charitable contributions for purposes of federal income tax); *id.* § 2055 (providing for deductibility of bequests to charitable organizations for purposes of federal estate tax); *id.* § 2522 (providing for deductibility of gifts to charitable organizations for purposes of federal gift tax).

4. See *id.* § 501(a), (c)–(d) (providing federal income tax exemption for certain types of charitable organizations).

5. Treas. Reg. § 1.501(c)(3)-1(b)(1)(i)(a) (as amended in 2014) (requiring limitation of purposes of certain tax-exempt organizations to those specified in I.R.C. § 501(c)(3)).

(including the publishing or distributing of statements), any political campaign on behalf of (or in opposition to) any candidate for public office.<sup>6</sup>

Plainly, the general tenor of section 501(c)(3) is consistent with traditional state-law notions of “what’s charitable.”<sup>7</sup> Nonetheless, there are obvious differences in both tone and detail. Testing for public safety may well now be widely viewed as charitable under state law, but this purpose’s presence and prominence in the section 501(c)(3) list are glaring.<sup>8</sup> That no substantial part of a charity’s activities can be focused on a legislative agenda is a far sharper limitation than most states prescribe.<sup>9</sup> And the supposedly absolute ban on electioneering is also well beyond what most states require.<sup>10</sup>

It is true that under state law the definition of charity has always been consciously open-ended and deeply intertwined with “public policy.”<sup>11</sup> But the states determined the bounds of the relevant public policy and its influence. Now, Congress, the IRS, and the federal courts often police, refine, and redefine the concept of charity and articulate the public policies that supposedly delimit it. In *Bob Jones University v. United States*,<sup>12</sup> for example, the Supreme Court of the United States upheld the authority of the IRS to deny the tax-exempt status of an acknowledged *university* run by an acknowledged *church*<sup>13</sup> because it discriminated on the basis of race in its admissions

6. I.R.C. § 501(c)(3).

7. See 6 SCOTT, FRATCHER & ASCHER, *supra* note 1, at ch. 38 (providing a comprehensive overview of charitable purposes as defined across time and jurisdiction).

8. See *id.* § 38.7.11 (discussion of community purposes traditionally viewed as charitable omits testing for public safety).

9. See *id.* § 38.7.1, 38.7.7–.7.9 (noting that most states do not withhold charitable status from organizations whose legislative activity consists exclusively of lobbying in favor of legislative changes generally beneficial to the community).

10. See *id.* § 38.7.8 (noting that organizations may be found charitable under state law even when they engage in electioneering so long as the relevant cause is charitable, as opposed to political).

11. See RESTATEMENT (THIRD) OF TRUSTS § 28 cmt. f (2003) (“Like other trusts, charitable trusts are subject to the rule . . . that trust purposes and provisions must not be unlawful or contrary to public policy.”); RESTATEMENT (SECOND) OF TRUSTS § 377 cmt. c (1959) (“A trust for a purpose the accomplishment of which is contrary to public policy . . . is invalid.”); 6 SCOTT, FRATCHER & ASCHER, *supra* note 1, § 38.11 (“A trust fails for illegality if the accomplishment of its purposes is contrary to public policy in the community in which the trust is created, when the trust is created.”); PRINCIPLES OF THE LAW OF CHARITABLE NONPROFIT ORGS. § 100(c) (Preliminary Draft No. 6, 2013) (on file with author) (stating that a purpose is not charitable if it is unlawful or against public policy).

12. 461 U.S. 574 (1983).

13. “The record . . . leaves no doubt . . . that Bob Jones University is both an educational institution and a religious institution.” *Id.* at 605 n.32. Education and religion are, of course, two of the most prototypically charitable purposes. See Statute of Charitable Uses, 1601, 43 Eliz., c. 4 (Eng.) (recognizing both educational and religious uses as charitable); PRINCIPLES OF THE LAW OF

policies,<sup>14</sup> notwithstanding that it claimed its policies emanated from religious dogma. The Court's rationale was that a charity failed to qualify as such for federal tax purposes if it violated "fundamental"<sup>15</sup> or "established"<sup>16</sup> public policy. In one sense, as we have already seen, there is nothing new here, because under state law charities have always had to be consistent with public policy.<sup>17</sup> Public policy, like beauty, however, is often mostly—or even entirely—in the eye of the beholder. It may be possible simply to treat *Bob Jones* as a race case,<sup>18</sup> the holding of which state attorneys general and courts will increasingly embrace or perhaps already have fully embraced. Still, the more general rationale of *Bob Jones* strongly suggests that the federal government has the final say, at least in any meaningful way, about what is charitable.<sup>19</sup> Indeed, subsequent IRS pronouncements have extended the federal prerogative to deny charitable status to

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CHARITABLE NONPROFIT ORGS., *supra* note 11, § 100(b)(2)–(3) (classifying both "education" and "promotion of religion" as charitable purposes).

14. See also Rev. Rul. 67-325, 1967-2 C.B. 113 (ruling that organizations that operate community recreational facilities are not eligible for charitable exemption from federal income taxation when access to such facilities is restricted on the basis of race); *Wright v. Regan*, 656 F.2d 820 (D.C. Cir. 1982) (*per curiam*) (enjoining IRS from granting tax-exempt status to any racially discriminatory school), *rev'd sub nom.* *Allen v. Wright*, 468 U.S. 737 (1984), *abrogated by* *Lexmark Int'l, Inc. v. Static Control Components, Inc.*, 134 S. Ct. 1377 (2014); *Green v. Connally*, 330 F. Supp. 1150 (D.D.C.) (permanently enjoining IRS from granting tax-exempt status to private schools in Mississippi that maintained racially discriminatory admissions policies), *aff'd per curiam sub nom.* *Coit v. Green*, 404 U.S. 997 (1971); Rev. Rul. 71-447, 1971-2 C.B. 230–31 ("[A] school not having a racially nondiscriminatory policy as to students is not 'charitable' within the common law concepts reflected in [federal law] and accordingly does not qualify as an organization exempt from [f]ederal income tax.").

15. *Bob Jones*, 461 U.S. at 592–94, 596 n.21, 598.

16. *Id.* at 586, 591.

17. See *supra* note 11 and accompanying text. Note also, however, that the *Principles of the Law of Charitable Nonprofit Organizations* added the word "fundamental" to its formulation of the public policy exception directly in response to the opinion in *Bob Jones*. PRINCIPLES OF THE LAW OF CHARITABLE NONPROFIT ORGS., *supra* note 11, § 100(c) & cmt. d.

18. See, e.g., I.R.S. Tech. Adv. Mem. 8910001 (Mar. 10, 1989) (extending the holding of *Bob Jones* to deny tax-exempt status to a trust organized for the benefit of "worthy and deserving [elderly] white persons" because its disbursements were restricted on the basis of race).

19. See Rev. Rul. 71-447, 1971-2 C.B. 230, 230 ("All charitable trusts . . . are subject to the requirement that the purpose of the trust may not be illegal or contrary to public policy." (emphasis added)); Johnny Rex Buckles, *Do Law Schools Forfeit Federal Income Tax Exemption When They Deny Military Recruiters Full Access to Career Services Programs?: The Hypothetical Case of Yale University v. Commissioner*, 41 ARIZ. ST. L.J. 1, 1–3 (2009) (arguing that, under federal law, it would be possible for a court to conclude that private law schools that deny military recruiters equal access to recruitment programs are not tax exempt, because it would violate "fundamental" public policy under the *Bob Jones* framework in light of federal law making certain benefits contingent upon such access); Johnny Rex Buckles, *Reforming the Public Policy Doctrine*, 53 U. KAN. L. REV. 397, 398 (2005) (noting the growing influence of federal requirements for tax-exempt status on what constitutes "fundamental" and "established" public policy across the several states).

include, among others, situations involving payments by a hospital in violation of a federal antikickback statute<sup>20</sup> and cruelty to animals.<sup>21</sup> True, all these examples relate “only” to taxes, but favorable federal tax consequences are essential to the viability of most modern charities.<sup>22</sup>

Nor are the income, gift, and estate taxes the only levers the federal government uses to define, refine, and redefine the concept of charity. For example, a little-discussed feature of the Affordable Care Act requires hospitals to establish written financial assistance policies, limit amounts charged for emergency and other medically necessary care to individuals eligible for assistance under those policies, and refrain from certain types of collection activities.<sup>23</sup> In addition, each hospital must conduct a “community health needs assessment” at least once every three years<sup>24</sup> or pay a \$50,000 excise tax.<sup>25</sup>

### III. REGULATING FIDUCIARY CONDUCT

State law imposes a variety of duties on charitable fiduciaries, as well as on private fiduciaries who administer funds for charitable purposes either temporarily or on a long-term basis, such as the

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20. I.R.S. Gen. Couns. Mem. 39,862 (Nov. 21, 1991).

21. I.R.S. Priv. Ltr. Rul. 200837039 (May 19, 2008).

22. See PRINCIPLES OF THE LAW OF CHARITABLE NONPROFIT ORGS. § 520 (Tentative Draft No. 4, 2013) (noting “the importance to most charities of obtaining and maintaining federal tax exemption and other favorable tax treatments”); PRINCIPLES OF THE LAW OF NONPROFIT ORGS. § 620 cmt. b (Tentative Draft No. 3, 2011) (“For some charities, loss of exemption can be catastrophic . . .”). On the other hand, Bob Jones University waited until 2000 to end the discriminatory policies at issue in the litigation that reached the Supreme Court. Johnny Rex Buckles, *Bob Jones University v. United States: A Journey Through Scripture and History*, in LAW AND RELIGION: CASES IN CONTEXT 85, 101 (Leslie C. Griffin ed., 2010). To this day, the university itself (as distinguished from certain associated charities) remains noticeably absent from the IRS online list of charities eligible to receive tax-deductible contributions. (The IRS has discontinued Publication 78, Cumulative List of Organizations Described in Section 170(c) of the IRC.) *Exempt Organizations Select Check for Bob Jones University in Greenville, S.C.*, INTERNAL REVENUE SERVICE, <http://apps.irs.gov/app/eos/pub78Search.do?ein1=&names=Bob+Jones+University&city=Greenville&state=SC&country=US&deductibility=all&dispatchMethod=searchCharities&submitName=Search>, archived at <http://perma.cc/7SLC-AYUY> (last updated Aug. 18, 2014); see also *Where to Give*, BOB JONES UNIVERSITY, <http://www.bju.edu/giving/where-to-give.php>, archived at <http://perma.cc/HN5W-UFDY> (last visited Aug. 24, 2014) (listing both deductible and nondeductible giving opportunities).

23. I.R.C. § 501(r) (2012) (enacted by Patient Protection and Affordable Care Act § 9007 (2010)).

24. *Id.* § 501(r)(3). The IRS has even threatened to revoke a hospital’s tax-exempt status for failing to comply. Community Health Needs Assessments for Charitable Hospitals, 78 Fed. Reg. 20,523, 20,527 (proposed Apr. 5, 2013).

25. I.R.C. § 4959. For final and temporary regulations, see T.D. 9629, 2013-37 I.R.B. 188.

executors of estates or the trustees of trusts whose beneficiaries include charities. Perhaps foremost among those duties is the duty of loyalty, which, generally speaking, forbids a fiduciary from taking any advantage of the position except compensation for serving as fiduciary.<sup>26</sup> But the duty of loyalty is only part of the story. State law also imposes the duty to administer a charity in accordance with its terms and applicable law,<sup>27</sup> the duty of care or prudence,<sup>28</sup> the duty to control and protect the charity's property,<sup>29</sup> and the duty to keep records,<sup>30</sup> to name only a few. Thus, state law remains central, at least

26. See UNIF. TRUST CODE § 802 & cmt. (amended 2004), 7C U.L.A. 588–94 (2006) (“A trustee shall administer the trust solely in the interests of the beneficiaries.”); RESTATEMENT (THIRD) OF TRUSTS § 78 & cmt. a (2007) (“[T]rustee has a duty to administer the trust solely in the interest of the beneficiaries, or solely in furtherance of its charitable purpose.”); PRINCIPLES OF THE LAW OF NONPROFIT ORGS. § 300 (Tentative Draft No. 1, 2007) (recognizing the duty of loyalty owed by charitable trustees); 3 SCOTT, FRATCHER & ASCHER, *supra* note 1, § 17.2 (5th ed. 2007).

27. See UNIF. TRUST CODE § 801, 7C U.L.A. 587 (“[T]rustee shall administer the trust in good faith, in accordance with its terms and purposes and the interests of the beneficiaries, and in accordance with this [Code]”); RESTATEMENT (THIRD) OF TRUSTS § 76 (2007) (“The trustee has a duty to administer the trust, diligently and in good faith, in accordance with the terms of the trust and applicable law.”); *id.* § 78(1) (trustee of charitable trust “has duty to administer the trust . . . solely in furtherance of its charitable purpose”); RESTATEMENT (SECOND) OF TRUSTS § 379 cmt. a (1959) (trustee of charitable trust must “administer it solely in the interest of effectuating the [trust’s] charitable purposes”); 3 SCOTT, FRATCHER & ASCHER, *supra* note 1, §§ 17.1, 17.14 (5th ed. 2007); Johnny Rex Buckles, *The Federalization of Fiduciary Obedience Norms in Tax Laws Governing Charities: An Introduction to State Law Concepts and an Analysis of Their Implications for Federal Tax Law*, 4 EST. PLAN. & COMMUNITY PROP. L.J. 197, 204–05 (2012) (summarizing various formulations of the duty of obedience across jurisdictions); Linda Sugin, *Resisting the Corporatization of Nonprofit Governance: Transforming Obedience in Fidelity*, 76 FORDHAM L. REV. 893, 904–05 (2007) (arguing for continued existence of legal duty for charitable fiduciaries to administer charitable organizations consistent with their charitable purposes).

28. See UNIF. TRUST CODE § 804, 7C U.L.A. 601 (“A trustee shall administer the trust as a prudent person would . . . .”); REVISED MODEL NONPROFIT CORP. ACT § 8.30(a)(2) (1987) (“A director shall discharge his or her duties . . . with the care an ordinarily prudent person in a like position would exercise under similar circumstances . . . .”); RESTATEMENT (THIRD) OF TRUSTS § 77 (2007) (“The trustee has a duty to administer the trust as a prudent person would . . . . The duty of prudence requires the exercise of reasonable care . . . .”); PRINCIPLES OF THE LAW OF NONPROFIT ORGS. §§ 300, 315 (Tentative Draft No. 1, 2007) (describing the duty of care); 3 SCOTT, FRATCHER & ASCHER, *supra* note 1, § 17.6 (5th ed. 2007).

29. See UNIF. TRUST CODE §§ 809, 812, 7C U.L.A. 606, 608 (describing the fiduciary’s duty to protect and control trust property); RESTATEMENT (THIRD) OF TRUSTS § 76(2)(b) (2007) (noting that trustees are charged with “collecting and protecting trust property”); 3 SCOTT, FRATCHER & ASCHER, *supra* note 1, §§ 17.7, 17.8 (5th ed. 2007).

30. See UNIF. TRUST CODE § 810, 7C U.L.A. 607 (“A trustee shall keep adequate records of the administration of the trust.”); RESTATEMENT (THIRD) OF TRUSTS § 83 (2007) (“A trustee has a duty to maintain clear, complete, and accurate . . . records regarding . . . the administration of the trust . . . .”); 3 SCOTT, FRATCHER & ASCHER, *supra* note 1, § 17.4 (5th ed. 2007).



in theory, to enforcing the fiduciary obligations of those who run or hold funds for charities.<sup>31</sup>

### *A. Impediments to State-Law Enforcement*

Unfortunately, there are huge impediments to state-law enforcement. First, we should not expect those who run charities readily or often to ask the courts to enforce duties against themselves. True, one or more trustees or members of a governing board may occasionally seek to involve a court in an internal dispute over management or control of a charity. Indeed, there are occasions when all of the trustees or board members seek judicial advice as to a certain course of conduct. But these occasions are few and far between; moreover, they usually involve charities whose managers, or at least some of them, are doing their utmost to run their charities well.

Second, charities hesitate to bite the hand that feeds them and thereby become known as “litigious.” Even when charities learn of fiduciary misconduct (by an executor or private trustee, for example) diametrically opposed to their own interests, they sometimes fail to seek judicial relief.<sup>32</sup> With the affected charity thus out of the litigation loop, standing raises its ugly head in a particularly significant way. Traditional black-letter law is that only the state attorney general and those with a “special” interest have standing to enforce a charitable trust.<sup>33</sup> Yet, for the most part, state attorneys general have been notoriously asleep at the wheel in enforcing charitable fiduciary norms.<sup>34</sup> In addition, state courts have generally

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31. See, e.g., PRINCIPLES OF THE LAW OF CHARITABLE NONPROFIT ORGS., *supra* note 11, § 130(a) (“The laws of a charity’s home state govern matters involving the charity’s internal affairs, including the performance of fiduciary duties . . .”).

32. This is one of the very reasons why state attorneys general are so widely tasked with supervising charities.

33. See 5 SCOTT, FRATCHER & ASCHER, *supra* note 1, § 37.3.10 (5th ed. 2008) (noting that attorneys general, trustees, and persons with special interests in the administration of the trust are generally the only parties who may sue for enforcement of a charitable trust).

34. See *id.* (“[I]n the absence of statutory reforms, the enforcement of charitable trusts has been more or less sporadic.”); Garry W. Jenkins, *Incorporation Choice, Uniformity, and the Reform of Nonprofit State Law*, 41 GA. L. REV. 1113, 1128–29 (2007) (according to author’s survey, nearly three-quarters of the states had, at most, one full-time attorney tasked with charitable oversight; seventeen had none); Kenneth L. Karst, *The Efficiency of the Charitable Dollar: An Unfulfilled State Responsibility*, 73 HARV. L. REV. 433, 451–52 (1960) (asserting that piecemeal enforcement of charitable trusts is due to practical inability of state attorneys general to monitor day-to-day activities of charitable trusts); Jonathan Klick & Robert H. Sitkoff, *Agency Costs, Charitable Trusts, and Corporate Control: Evidence From Hershey’s Kiss-Off*, 108 COLUM. L. REV. 749, 816–19 (2008) (suggesting that supervision of charitable trusts by state attorneys general is inefficient and outlining alternative supervisory frameworks); Robert Franklin, *Critics*

been slow to identify plaintiffs with interests sufficiently special to merit standing.<sup>35</sup> Even donors themselves have, until very recently, generally not had standing to enforce *their own* charitable trusts.<sup>36</sup>

Finally—and perhaps most importantly—many charities are organized not as trusts, as to which the full rigor of trust law is at least in theory available to control fiduciary behavior, but as not-for-profit corporations, as to which a substantially less rigorous set of rules regulates fiduciary behavior.<sup>37</sup> What all this surely means is that the number of instances in which state courts are invited to review claims involving charitable fiduciary misconduct is merely the tip of a very large iceberg.<sup>38</sup> Indeed, the small number of reported cases

*Say Charity Watchdogs Are Nearly Toothless; Many State Agencies Have Inadequate Staff, Resources*, MINNEAPOLIS STAR TRIB., Sept. 28, 1992, at 03B (quoting former Illinois charities bureau chief, “[W]e should tell our citizens that nobody in Illinois is looking at this stuff. If you want to give to a charity, you’re on your own.”).

35. See, e.g., 5 SCOTT, FRATCHER & ASCHER, *supra* note 1, § 37.3.10 (5th ed. 2008) (noting that courts generally require a showing that an individual is “entitled to benefits under the trust that are greater than or different from those to which members of the public are entitled generally” before they are willing to find that a third party has a sufficiently special interest to merit standing in a suit seeking to enforce a charitable trust).

36. *Id.*

37. See Carter G. Bishop, *The Deontological Significance of Nonprofit Corporate Governance Standards: A Fiduciary Duty of Care Without a Remedy*, 57 CATH. U. L. REV. 701 (2008) (asserting that duties imposed upon directors of nonprofit corporations are an ineffective tool due to lax enforcement regimes); Evelyn Brody, *Agents Without Principals: The Economic Convergence of the Nonprofit and For-Profit Organizational Forms*, 40 N.Y.L. SCH. L. REV. 457, 466–67 (1996) (“[T]he law . . . imposes the fiduciary duties of loyalty and care on nonprofit boards. But, because of the lack of classes of private persons with standing to sue, in many ways this is a legal obligation without a legal sanction.”); Evelyn Brody, *Charity Governance: What’s Trust Law Got to Do with It?*, 80 CHI.-KENT L. REV. 641 (2005) (advocating migration from the nonprofit corporate form to the charitable trust form to improve nonprofit governance); Evelyn Brody, *The Limits of Charity Fiduciary Law*, 57 MD. L. REV. 1400 (1998) [hereinafter Brody, *The Limits*] (recognizing the weak controls available to ensure that nonprofit corporations perform their charitable purposes effectively); Evelyn Brody, *Sunshine and Shadows on Charity Governance: Public Disclosure as a Regulatory Tool*, 12 FLA. TAX REV. 183, 195–96 (2012) [hereinafter Brody, *Sunshine and Shadows*] (describing typical state involvement as the secretary of state issuing a certificate of incorporation and receiving annual filings; only a few states require registration or filings with the attorney general); Henry B. Hansmann, *The Evolving Law of Nonprofit Organizations: Do Current Trends Make Good Policy?*, 39 CASE W. RES. L. REV. 807, 814–16 (1989) (describing the trend in corporate law towards aligning the legal duties of directors of nonprofit corporations with the duties required of directors of for-profit corporations, rather than with the stricter duties required of charitable fiduciaries); Henry B. Hansmann, *Reforming Nonprofit Corporation Law*, 129 U. PA. L. REV. 497 (1981) (providing a broad overview of the nonprofit corporate form); Sugin, *supra* note 27 (advocating higher fiduciary duty for directors of charitable nonprofit corporations).

38. One study reports, for example, that charities commonly enter into transactions with board members for both goods and services. See Francie Ostrower, *Nonprofit Governance in the United States: Findings on Performance and Accountability from the First National Representative Study*, URBAN INSTITUTE 7 (2007), [http://www.urban.org/UploadedPDF/411479\\_Nonprofit\\_Governance.pdf](http://www.urban.org/UploadedPDF/411479_Nonprofit_Governance.pdf), archived at <http://perma.cc/WN9G-86YP>.

involving charitable fiduciary misconduct each year seems to bear out this suspicion.<sup>39</sup>

### *B. Federal Regulation*

In contrast, there are numerous ways in which federal law seeks to, and no doubt does, deter fiduciary misconduct involving charities.<sup>40</sup> The very same tax provisions that identify entities as charitable require not only that they be *organized* to pursue certain defined charitable objectives but also that they be *operated* to do so.<sup>41</sup> Under the regulations, a section 501(c)(3) entity must engage “primarily in activities which accomplish” its exempt purposes.<sup>42</sup> If “more than an insubstantial part of its activities is not in furtherance of an exempt purpose,” the entity fails this so-called operational test,<sup>43</sup> which seems plainly designed as a federal backstop to what state trust law requires by way of the duty to administer a charity in accordance with its terms and applicable law.

One of the most prominent federal precepts to which charitable entities must adhere is that “no part of the net earnings . . . inure[ ] to the benefit of any private shareholder or individual.”<sup>44</sup> Enforcement of this precept directly mimics the state law duty of loyalty,<sup>45</sup> and there is every reason to believe not only that charities are keen on avoiding

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39. See Brody, *Sunshine and Shadows*, *supra* note 37, at 214 (“Few cases involving nonprofit fiduciary issues have reached the courts.”).

40. See PRINCIPLES OF THE LAW OF CHARITABLE NONPROFIT ORGS., *supra* note 11, § 130 cmt. e(1) (“The rules of federal tax exemption essentially create a uniform floor for charity fiduciaries, and the Internal Revenue Service enforces the requirements of the Internal Revenue Code independently of state enforcement of nonprofit laws.”); Brody, *The Limits*, *supra* note 37, at 1414 (“Regulatory authority over nonprofit fiduciaries . . . has moved increasingly to the federal level . . .”); Johnny Rex Buckles, *The Federalization of the Duty of Loyalty Governing Charity Fiduciaries Under United States Tax Law*, 99 KY. L.J. 645, 646 (2011) (“[T]he duty of loyalty owed by trustees of charitable trusts and directors of charitable corporations under state law is now largely eclipsed by federal tax laws that effectively regulate fiduciary behavior.”); Henry Hansmann, Discussant Remarks and Audience Questions at the Case Western Reserve Law Review Symposium: What Is Charity? Implications for Law and Policy (Nov. 4, 1988), 39 CASE W. RES. L. REV. 829, 837 (1989) (“We have turned to federal tax law to establish the fiduciary duties of officers and directors. It has been federal tax law by default because the state corporation statutes have been empty . . . on the subject. Section 501 therefore imposes the duties for most nonprofit institutions.”).

41. I.R.C. § 501(c)(3)–(4) (2012).

42. Treas. Reg. § 1.501(c)(3)-1(c)(1) (as amended in 2014).

43. *Id.*

44. I.R.C. § 501(c)(3)–(4).

45. See Buckles, *supra* note 40, at 661–62 (“[T]he prohibition against private inurement . . . largely subsumes the duty of loyalty. When a charity violates the prohibition against private inurement, the violation will often be explained by a breach of the duty of loyalty.”).

difficulties of this sort<sup>46</sup> but also that the IRS is keen on making sure that they do.<sup>47</sup> In addition, federal law requires that the governing instruments of private foundations prohibit acts of self-dealing and other activities that would result in imposition of any of a number of federal excise taxes, as a condition of gaining tax-exempt status.<sup>48</sup>

As the recent scandal involving primarily Tea Party and other conservative groups proves, the IRS sometimes expends considerable resources purporting to ensure that at least certain charities or pseudo-charities are, in fact, operated in accordance with federal

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46. See, e.g., Michael W. Peregrine et al., *Transparency: What the EO Board Needs to Know About Executive Compensation*, 46 EXEMPT ORG. TAX REV. 23 (2004) (noting a trend toward increased board participation in executive compensation decisionmaking as a means to ensure that the organization is not in violation of the prohibition on private inurement).

47. See, e.g., Treas. Reg. § 501(c)(3)-1(d)(1)(ii) (defining the precept as a general prohibition against “private interest,” as opposed to merely inurement for the benefit of certain insiders); *United Cancer Council, Inc. v. Comm’r*, 165 F.3d 1173, 1176 (7th Cir. 1999) (rejecting IRS claims that the charity’s exclusive relationship with a fundraising company deprived it of tax-exempt status); *Founding Church of Scientology v. United States*, 412 F.2d 1197, 1201 (Cl. Ct. 1969) (authorizing collection of taxes from a church when evidence indicated that members of the board made personal use of its income); *Am. Campaign Acad. v. Comm’r*, 92 T.C. 1053, 1070 (1989) (upholding IRS denial of petitioner’s request for tax-exempt status because its net earnings inured to the benefit of Republican candidates and entities more than incidentally); *Church of Scientology of Cal. v. Comm’r*, 83 T.C. 381, 454 (1984) (upholding IRS revocation of petitioner’s tax-exempt status because, *inter alia*, its net earnings inured to the benefit of key personnel within the church), *aff’d*, 823 F.2d 1310 (9th Cir. 1987); I.R.S. Priv. Ltr. Rul. 200736031 (Sept. 7, 2007) (“The Service’s position is that the payment of [a portion of the organization’s earnings] to a corporation closely held by the [d]irector [of the organization] establishes that [the organization] operates for a substantial[ly] non exempt purpose.”); I.R.S. Priv. Ltr. Rul. 200535029 (Sept. 2, 2005) (ruling that an organization with no historical revenues or expenses failed to satisfy the operational test when there was reason to suspect that the organization’s earnings would inure to the benefit of one or more board members); I.R.S. Priv. Ltr. Rul. 200514021 (Apr. 8, 2005) (ruling that an organization created to offer debt counseling to the public was not tax-exempt because its board members provided these services for profit); I.R.S. Priv. Ltr. Rul. 200510031 (Mar. 11, 2005) (ruling that an organization failed the operational test because of the high risk of private inurement associated with the fact that its officers and board members were all closely related); I.R.S. Priv. Ltr. Rul. 199907021 (May 20, 1998) (ruling that a transaction with a board member did not disqualify an organization from tax-exempt status so long as the transaction was for fair market value and at arm’s-length); I.R.S. Gen. Couns. Mem. 37,789 (Dec. 18, 1978) (opining that a hospital’s lease of land to a physician group would not inure to private benefit so long as the lease was at fair rental value); INTERNAL REVENUE SERV., GOVERNANCE AND RELATED TOPICS—501(C)(3) ORGANIZATIONS (2008) (discussing the importance of executive compensation policies), available at [http://www.irs.gov/pub/irs-tege/governance\\_practices.pdf](http://www.irs.gov/pub/irs-tege/governance_practices.pdf), archived at <http://perma.cc/699F-HMWL>; I.R.S. Form 990, Return of Organization Exempt from Income Tax, pt. VI (OMB No. 1545-0047) (2013) (requesting detailed information about the structure of exempt organizations’ boards and management teams); I.R.S. Form 1023, Application for Recognition of Exemption, pt. V (OMB No. 1545-0056) (2013) (requesting detailed information regarding compensation arrangements with applicant organizations’ board members and employees).

48. I.R.C. § 508(e)(1)(B).

guidelines.<sup>49</sup> One of these guidelines requires that section 501(c)(3) charities “not participate in, or intervene in (including the publishing or distributing of statements), any political campaign on behalf of (or in opposition to) any candidate for public office.”<sup>50</sup> There is clear evidence that the IRS has long taken its responsibility regarding this mandate seriously, at least to the extent of articulating its view of the law and making occasional efforts at seeming to enforce it.<sup>51</sup> There is,

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49. See generally Lily Kahng, *The IRS Tea Party Controversy and Administrative Discretion*, 99 CORNELL L. REV. ONLINE 41 (2013) (describing the Tea Party scandal and the measures the IRS has sometimes taken to ensure that certain charitable organizations comply with the requirements of I.R.C. § 501(c)).

50. I.R.C. § 501(c)(3); see also *id.* § 170(c)(2)(D) (specifying qualifications to receive tax-deductible charitable contributions). In contrast, social welfare organizations, listed in I.R.C. § 501(c)(4), which never qualify to receive tax-deductible charitable contributions, and which seem to have been the “charitable” misfits involved in the recent IRS scandal, may directly engage in political campaign activities, so long as such activities are not their primary activity. See Treas. Reg. § 1.501(c)(4)-1(a)(2) (as amended in 1990) (permitting “action organizations” to qualify as exempt social welfare organizations under I.R.C. § 501(c)(4) under specified conditions); Rev. Rul. 81-95, 1981-1 C.B. 332, 332 (“An organization primarily engaged in the promotion of social welfare may participate in lawful political campaign activities involving the nomination or election of public officials without adversely affecting its exempt status.”). *But see* I.R.S. News Release IR-2013-92 (Nov. 26, 2013) (proposing regulations under which promotion of social welfare would not include direct or indirect “candidate-related political activity,” and requesting comments on what portion of exempt organizations’ activities must be devoted to promoting social welfare and whether there should be additional limits on activities that do not).

51. See, e.g., Treas. Reg. § 1.501(c)(3)-1(c)(3)(i), (iii)–(iv) (as amended in 2014) (defining “action organizations” and withholding exempt status under I.R.C. § 501(c)(3) from certain organizations); *Ass’n of the Bar of the City of N.Y. v. Comm’r*, 858 F.2d 876, 878 (2d Cir. 1988) (reversing lower court’s finding that appellee qualified as tax-exempt because its involvement in rating and endorsing judicial candidates constituted prohibited political activity); *United States v. Dykema*, 666 F.2d 1096, 1101 (7th Cir. 1981) (noting that I.R.S. strictly construes the prohibition on participation by exempt organizations in any campaign for public office); Rev. Rul. 2007-41, 2007-1 C.B. 1421, 1422–26 (providing comprehensive guidance regarding prohibition against participation in political campaigns for public office under twenty-one separate factual scenarios); Rev. Rul. 86-95, 1986-2 C.B. 73, 74 (permitting an exempt educational organization to conduct a public forum for qualified congressional candidates despite the prohibition on participating in any political campaign so long as the forum does not demonstrate bias “for or against” a particular candidate); Rev. Rul. 78-248, 1978-1 C.B. 154, 154 (permitting exempt organizations to participate in certain “voter education” activities so long as they are conducted in a “nonpartisan manner”); I.R.S. Tech. Adv. Mem. 200446033 (Nov. 12, 2004) (ruling that a hospital that allowed employees to contribute to a political action campaign via payroll deduction violated the prohibition on participation in campaign activity); I.R.S. Tech. Adv. Mem. 199907021 (Feb. 19, 1999) (ruling that an exempt organization did not participate in a political campaign when it engaged in efforts in support of certain policies and initiatives aligned with a specific candidate’s platform); I.R.S. Tech. Adv. Mem. 199117001 (Apr. 26, 1991) (ruling that an exempt organization engaged in prohibited campaign activity when it engaged in a mail-based voter registration campaign because the materials were intended to influence voters to vote for President Reagan); I.R.S. Gen. Couns. Mem. 39,441 (Nov. 7, 1985) (finding that an organization engages in prohibited campaign activity when it “rates numerous candidates for elective office”); DANIEL WERFEL, INTERNAL REVENUE SERV., CHARTING A PATH FORWARD AT THE IRS: INITIAL ASSESSMENT AND PLAN OF ACTION (2013), available at <http://www.irs.gov/PUP/newsroom/Initial%20Assessment%20and%20Plan%20of%20Action.pdf>, archived at <http://perma.cc/RER3->

as well, clear evidence that Congress is quite serious, on at least a formal level, about keeping charities out of politics, in that it has given the IRS authority to make termination assessments in the case of “flagrant political expenditures” by section 501(c)(3) organizations.<sup>52</sup> On the other hand, how often, and under what circumstances, the IRS actually chooses to impose what amounts to a death penalty on *any* real charity—let alone a church—is quite another matter. The answer is, surely, “Not often.” It is clear, for example, that the IRS is *extremely* leery about revoking any “real” church’s tax-exempt status.<sup>53</sup> There is, in addition, a real question about just how serious the IRS is—or should be—about even rattling its saber along this inherently messy and highly politically charged borderline.<sup>54</sup>

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EYRF (detailing expedited approval process for long-pending applications); POLITICAL ACTIVITIES COMPLIANCE INITIATIVE, INTERNAL REVENUE SERV., FINAL REPORT (2006), *available at* [http://www.irs.gov/pub/irs-tege/2006paci\\_report\\_5-30-07.pdf](http://www.irs.gov/pub/irs-tege/2006paci_report_5-30-07.pdf), *archived at* <http://perma.cc/HF43-TPJN> (finding 269 potential instances of contributions to political campaigns by section 501(c)(3) exempt organizations between 2003 and 2005; 65 of the 92 closed cases involved prohibited political activity).

52. I.R.C. § 6852.

53. See H.R. REP. NO. 100-391(I), at 1624 (1987) (noting insufficient IRS enforcement of ban on political activity); Dan Gilgoff, *Turning a Blind Eye, IRS Enables Church Politicking*, USA TODAY, Jan. 29, 2007, at 13A (reporting an IRS spokeswoman’s estimation that only five churches have *ever* lost their tax exemptions for engaging in political activity), *available at* <http://usatoday30.usatoday.com/printedition/news/20070129/opledereligion62.art.htm>, *archived at* <http://perma.cc/69LQ-ASZ6>.

54. See, e.g., *Freedom From Religion Found., Inc. v. Shulman*, 961 F. Supp. 2d 947, 950 (W.D. Wis. 2013) (refusing to dismiss claim for declaratory and injunctive relief against the IRS for enforcing electioneering rules against charities generally but not against churches). Compare Johnny Rex Buckles, *Does the Constitutional Norm of Separation of Church and State Justify the Denial of Tax Exemption to Churches that Engage in Partisan Political Speech?*, 84 IND. L.J. 447, 447 (2009) (“The inquisitions have begun.”), Johnny Rex Buckles, *Is the Ban on Participation in Political Campaigns by Charities Essential to Their Vitality and Democracy? A Reply to Professor Tobin*, 42 U. RICH. L. REV. 1057, 1059–60 (2008) (noting the seriousness with which the IRS purports to approach its enforcement obligations with respect to the prohibition on participation in political campaigns), Johnny Rex Buckles, *Not Even a Peep? The Regulation of Political Campaign Activity by Charities Through Federal Tax Law*, 75 U. CIN. L. REV. 1071, 1072 (2007) (suggesting that enforcement of the prohibition on participation in political campaigns is “by no means uncommon”), and Donald B. Tobin, *Political Campaigning by Churches and Charities: Hazardous for 501(c)(3)s, Dangerous for Democracy*, 95 GEO. L.J. 1313, 1315 (2007) (suggesting that the IRS has recently escalated its enforcement of the campaign prohibition in response to an uptick in allegations of violations thereof), with Dallas Dean, *A Little Rule That Goes a Long Way: A Simplified Rule Enforcing the 501(c)(3) Ban on Campaign Intervention*, 28 J.L. & POL. 307, 307–08 (2013) (arguing that, despite increased investigation of violations of the prohibition on electioneering, imposition of sanctions is relatively spotty), Michael Hatfield, *Ignore the Rumors—Campaigning from the Pulpit Is Okay: Thinking Past the Symbolism of Section 501(c)(3)*, 20 NOTRE DAME J.L. ETHICS & PUB. POL’Y 125, 127 (2006) (citing minimal imposition of sanctions for violation of the prohibition on campaign activity by churches and other exempt organizations prior to 2006), Patrick L. O’Daniel, *More Honored in the Breach: A Historical Perspective of the Permeable IRS Prohibition on Campaigning by Churches*, 42 B.C. L. REV. 733, 736–40 (2001) (citing many examples of electioneering by churches and associated personnel

Another federal guideline requires that “no substantial part of the activities” of a section 501(c)(3) charity be “carrying on propaganda, or otherwise attempting, to influence legislation.”<sup>55</sup> Though this guideline is obviously not absolute and may in certain instances be legitimately sidestepped,<sup>56</sup> here too the IRS has sought to stake out a position and sometimes to appear to enforce it.<sup>57</sup>

There are additional, less prominent federal restrictions on a charity’s behavior. There is, for example, the so-called commerciality doctrine, which acknowledges that a charity may operate a commercial business but insists that it be “in furtherance of the organization’s exempt purpose or purposes,” and not vice versa.<sup>58</sup>

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during the run-up to the 2000 election and the “slackness of enforcement” by the IRS), and Daniel C. Willingham, “Are You Ready for Some (Political) Football?” *How Section 501(c)(3) Organizations Get Their Playing Time During Campaign Seasons*, 28 AKRON TAX J. 83, 90 n.36 (2013) (suggesting that IRS enforcement of the prohibition on electioneering has been paltry despite increasing involvement of exempt organizations in political campaigns).

55. I.R.C. § 501(c)(3); *see also id.* § 170(c)(2)(D) (prohibiting organizations that publish or distribute statements in support or opposition of a political campaign from receiving tax-deductible charitable contributions).

56. *See id.* § 501(h) (permitting certain charities to elect to engage in specified amounts of lobbying).

57. *See, e.g.*, Treas. Reg. § 1.501(c)(3)-1(c)(3)(i)–(ii), (iv) (as amended in 2014) (providing that an organization that advocates specific action on specific legislative acts as a substantial part of its activities fails the operational test and is ineligible for tax-exempt status); *Regan v. Tax’n with Representation*, 461 U.S. 540, 551 (1983) (“The issue in this case is not whether TWR must be permitted to lobby, but whether Congress is required to provide it with public money with which to lobby. . . . [W]e hold that it is not.”); *Christian Echoes Nat’l Ministry, Inc. v. United States*, 470 F.2d 849, 855 (10th Cir. 1972) (affirming IRS determination that nonprofit religious corporation failed the organizational test because a substantial part of its operations consisted of publishing a periodical that contained numerous articles “aiming to influence legislation by appeal[ing] to the public to react to certain issues”); *Kuper v. Comm’r*, 332 F.2d 562, 562–63 (3d Cir. 1964) (holding that an organization was not eligible for tax exemption when lobbying and preparing to lobby for action on specific legislation constituted a substantial portion of the organization’s activities); *League of Women Voters v. United States*, 180 F. Supp. 379 (Cl. Ct. 1960) (holding that an organization was not eligible to receive tax-deductible charitable contributions when a substantial portion of its activities consisted of efforts to influence legislation or discussing what positions to take on “questions of public interest”).

58. Treas. Reg. § 1.501(c)(3)-1(e)(1) (as amended in 2014); *see also* *Family Trust of Mass., Inc. v. United States*, 722 F.3d 355 (D.C. Cir. 2013) (holding that a commercial organization that charged fees to serve as trustee for charitable trusts did not qualify for exempt status because its commercial activity furthered non-exempt purposes more than insubstantially); *Living Faith, Inc. v. Comm’r*, 950 F.2d 365, 372–76 (7th Cir. 1991) (holding that a nonprofit health ministry was not operated in furtherance of exempt purposes when a substantial portion of its commercial operations were effectively indistinguishable from similar services provided by non-exempt organizations); *Presbyterian & Reformed Publ’g Co. v. Comm’r*, 743 F.2d 148, 152 (3d Cir. 1984) (articulating a two-part test for whether a nonprofit organization that engages in substantial commercial activity qualifies for exemption); *Partners in Charity, Inc. v. Comm’r*, 141 T.C. 151 (2013) (holding that IRS correctly found that a nonprofit organization whose alleged purpose was to provide down-payment assistance grants to homebuyers was ineligible for exemption because its fee-for-service transactions with home sellers constituted substantial commercial activity not

Likewise, federal law requires that a charity's charitable program be "commensurate in scope with its financial resources."<sup>59</sup>

What all these requirements—the operational test, the ban on private inurement, the rules relating to campaign involvement and lobbying, the commerciality doctrine, and the "commensurate in scope" standard—have in common is an insistence at the federal level, often lacking at the state level, that a charity behave like a charity. Nor is there the slightest doubt that the threat of IRS scrutiny often affects the behavior of those who operate charities.<sup>60</sup> For one thing, having to deal with inquiries (or worse) from the IRS imposes on a charity numerous costs, including the loss of time of both management and staff and the accrual of legal and/or accounting fees. Extreme cases may generate adverse publicity, which may in turn substantially crimp contributions.<sup>61</sup> More prominent, if mostly hypothetical, is the risk that the IRS will conclude that the charity no longer qualifies for tax exemption, or receipt of tax-deductible charitable contributions.<sup>62</sup>

### *C. Federal Excise Taxes*

There is reason to believe that the all-or-nothing approach of denying a charity's tax-exempt status is such a draconian penalty that

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in furtherance of its charitable purposes); *Church of Scientology v. Comm'r*, 83 T.C. 381, 477 (1984) (upholding IRS finding that a religious organization failed the organizational test because its principal means of distributing religious products and services was commercial in nature), *aff'd*, 823 F.2d 1310 (9th Cir. 1987); *Scripture Press Found. v. United States*, 285 F.2d 800, 806 (Cl. Ct. 1961) (holding that a nonprofit educational foundation that published religious literature did not qualify as an exempt organization because its earnings from commercial activities substantially outweighed expenditures on its alleged educational purpose).

59. Rev. Rul. 64-182, 1964-1 C.B. 186, 187; *see also* John C. Colombo, *Regulating Commercial Activity by Exempt Charities: Resurrecting the Commensurate-in-Scope Doctrine*, 39 EXEMPT ORG. TAX REV. 341, 341-42 (2003) (proposing a renewed "commensurate-in-scope" doctrine as a tool to resolve confusion about acceptable levels of commerciality of exempt organizations); Sugin, *supra* note 27, at 921-22 (comparing the "commensurate-in-scope" test to a charitable fiduciary's duty of fidelity to the entity's charitable purposes); *see generally* Jack B. Siegel, *Commensurate in Scope—Myth, Mystery, or Ghost?* (pts. I & II), TAX'N OF EXEMPTS, Nov.-Dec. 2008, at 26, TAX'N OF EXEMPTS, Jan.-Feb. 2009, at 8 (providing comprehensive overview of the doctrine and its applicability in various contexts).

60. *See, e.g.*, Steven B. Imhoof, Note, *The Politics of Politicking Under IRC § 501(c)(3): A Guide for Politically Active Churches*, 5 NEXUS 97, 98-105 (2000) (summarizing statutes, regulations, and jurisprudence governing political activity by exempt organizations for benefit of "politically active churches").

61. *See* PRINCIPLES OF THE LAW OF NONPROFIT ORGS. § 620 cmt. b (Tentative Draft No. 3, 2011) (discussing catastrophic impact of loss of exemption on nonprofit organizations).

62. *See* I.R.C. § 501(c)(3) (setting qualifications for tax-exempt status); Alan L. Feld, *Rendering Unto Caesar or Electioneering for Caesar? Loss of Church Tax Exemption for Participation in Electoral Politics*, 42 B.C. L. REV. 931, 932-34 (2001). *But see supra* text accompanying notes 53-54.



the IRS is less inclined to use it than perhaps it should be. Added to the traumatic, if not catastrophic, consequences for the charity involved are chronic IRS understaffing and undertraining problems; the unduly liberal and sometimes amorphous statutory and regulatory standards for tax-exempt status; the tendency of the IRS to try to help charities remediate their problems, rather than simply to enforce the law; and the worry (often validated) that Congress will seek to bring the IRS to heel if it ever goes “too far” in enforcing Congress’ own laws against one or more politically sensitive charities or classes of charities.<sup>63</sup> Perhaps, in large part, for just these reasons, a number of federal excise taxes seek to ensure that charities adhere, on their own, to their charitable purposes.

Many of these excise taxes, particularly those to which private foundations are subject, first appeared in the Tax Reform Act of 1969. They were born of congressional concern that the charitable sector, although a huge beneficiary of tax incentives at all levels of government, but particularly at the federal level, had become essentially accountable to no one.<sup>64</sup> One can fairly say that many of these taxes enforce the duty of loyalty and any number of other fiduciary duties, albeit at the federal level. More generally, they encourage those who run charities to operate them *as* charities.

There is, for example, an entire series of taxes on acts of “self-dealing,”<sup>65</sup> very broadly defined,<sup>66</sup> in the case of transactions involving private foundations.<sup>67</sup> Just a few of the many transactions subject to

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63. See PRINCIPLES OF THE LAW OF NONPROFIT ORGS. § 620 cmt. (c)(1) (Tentative Draft No. 3, 2011). For a thoughtfully annotated catalog of the many ways in which the IRS interacts with and often seeks to help charities, see *id.* Reporter’s Notes. The Tax Exempt and Government Entities (“TE/GE”) Division of the IRS is unique in that it relates not directly to the generation of revenue, but to the regulation of charities: “Governed by complex, highly specialized provisions of the tax law, the sector is not designed to generate revenue, but rather to ensure that the entities fulfill the policy goals that their tax exemption was designed to achieve.” *Id.* § 620 cmt. a; see generally *Tax Exempt & Government Entities Division At-a-Glance*, INTERNAL REVENUE SERVICE, <http://www.irs.gov/uac/Tax-Exempt-&-Government-Entities-Division-At-a-Glance>, archived at <http://perma.cc/3V37-747S> (last updated July 16, 2014).

64. See STAFF OF THE JOINT COMM. ON INTERNAL REVENUE TAXATION, 91ST CONG., GENERAL EXPLANATION OF THE TAX REFORM ACT OF 1969, pt. I, at 3–4, pt. III.A–B, at 29–74 (1970) [hereinafter GENERAL EXPLANATION], available at <https://ia600302.us.archive.org/26/items/generalexplanati00jcs1670/generalexplanati00jcs1670.pdf>, archived at <http://perma.cc/6GR3-HRLJ> (discussing tax reform measures).

65. I.R.C. § 4941.

66. See *id.* § 4941(d).

67. *Id.* § 4941(a)(1). Very generally, a private foundation is a tax-exempt charity, unaffiliated with any other tax-exempt charity, which is not funded with contributions or other receipts from a broad segment of the public, other than certain so-called public charities, such as churches, schools, and hospitals. See *id.* § 509(a). Often, private foundations are the creations of a single individual, couple, or family.

these taxes are sales and exchanges of property, leases, and loans between the foundation and a “disqualified person.”<sup>68</sup> In the case of the “self-dealer,” the tax is “equal to 10 percent of the amount involved with respect to the act of self-dealing for each year (or part thereof).”<sup>69</sup> In the case of a foundation manager, the tax is equal to 5 percent of the same amount.<sup>70</sup> If the act is not “corrected” in a timely fashion, there is an additional tax on the self-dealer “equal to 200 percent of the amount involved.”<sup>71</sup> In addition, there is a tax “equal to 50 percent of the amount involved” on any foundation manager who refuses to agree to part or all of the correction.<sup>72</sup>

Obviously Congress chose the persons on whom to impose these taxes and the rates at which to impose them in the hopes of providing serious deterrents to the misuse of charitable assets. Presumably Congress believed that the parallel state-law deterrents were inadequate, as they plainly are, at least in the case of not-for-profit corporations.<sup>73</sup> In addition, Congress may have believed that limiting the IRS to the all-or-nothing approach of revoking a charity’s exempt status was insufficiently flexible to be practically effective. The taxes apply, however, even in the case of charitable trusts, on fact patterns that would be slam-dunk violations of the state-law duty of loyalty. Indeed, the taxes apply regardless of whether state-law enforcement mechanisms work generally or even whether they already have worked in the situation at hand. In the aftermath of the famous *Rothko* case, for example, in which the New York courts imposed joint and several personal liability exceeding \$7 million on those found to have enriched themselves at the expense of the foundation,<sup>74</sup> the IRS sought to impose punishing excise taxes on the very same individuals

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68. *Id.* § 4941(d)(1)(A)–(B).

69. *Id.* § 4941(a)(1).

70. *Id.* § 4941(a)(2). The tax applies, however, only to a foundation manager who participated in an act of self-dealing “knowing that it [was] such an act.” *Id.* Even then, it applies only if the manager’s participation was “willful” and not “due to reasonable cause.” *Id.* In any event, the tax on the manager cannot exceed \$20,000 for “any one act of self-dealing.” *Id.* § 4941(c)(2).

71. *Id.* § 4941(b)(1).

72. *Id.* § 4941(b)(2). Here, too, the tax cannot exceed \$20,000 for “any one act of self-dealing.” *Id.* § 4941(c)(2).

73. See Johnny Rex Buckles, *Fiduciary Assumptions Underlying the Federal Excise Taxation of Compensation Paid by Charities*, 45 REAL PROP. TR. & EST. L.J. 53, 69 (2010) (“[T]he most basic assumption of section 4941 [is that] regulating fiduciary behavior through the enforcement of state law fiduciary duties is insufficient.”).

74. *Estate of Rothko v. Reis (In re Estate of Rothko)*, 372 N.E.2d 291, 294–95, 300 (N.Y. 1977).

to the tune of more than \$20 million each.<sup>75</sup> Less sensationally, the IRS can and does use the taxes to deter and penalize the payment of excessive compensation to foundation managers.<sup>76</sup> The taxes on self-dealing more or less track, but substantially fortify, enforcement of state trust law concepts of the duty of loyalty. As to not-for-profit corporations, moreover, they supply a body of law virtually missing at the state level, and to that extent, frequently apply to transactions that would have attracted little or no scrutiny otherwise.<sup>77</sup>

Private foundations also face federal excise taxes on “taxable expenditures.”<sup>78</sup> These are a motley group of transactions, to which we shall return,<sup>79</sup> but for now it is sufficient to note that the term includes certain types of grants directly to individuals, grants to non-qualifying organizations, and, perhaps most informatively, expenditures “for any purpose other than one specified in section 170(c)(2)(B).”<sup>80</sup> Plainly, the primary target of the tax is activity that is, or arguably is, not “charitable,” at least in the sense that federal tax law specifies. Similar taxes apply with respect to donor-advised

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75. *Estate of Reis v. Comm’r*, 87 T.C. 1016, 1017 (1986) (more than \$21 million); *Stamos v. Comm’r*, 87 T.C. 1451, 1451 (1986) (more than \$23 million).

76. *See, e.g.*, I.R.S. Tech. Adv. Mem. 9008001 (Feb. 23, 1990). Under the initial wording of the statute, payment of any compensation to a disqualified person seems to attract the taxes on self-dealing. *See* I.R.C. § 4941(d)(1)(D). Nonetheless, such payments avoid taxation in the ordinary course, i.e., whenever they are “for personal services which are reasonable and necessary to carrying out the exempt purpose of the private foundation” and the “compensation . . . is not excessive.” *Id.* § 4941(d)(2)(E); *see also* Treas. Reg. §§ 53.4941(d)-2(c)(4), 53.4941(d)-3(c)(1)–(2) exs. (1)–(3) (providing personal or banking services is not self-dealing if services are reasonable and compensation is not excessive); Rev. Rul. 74-591, 1974-2 C.B. 385 (pension to disqualified person not excessive); I.R.S. Priv. Ltr. Rul. 200135047 (June 7, 2001) (ruling that fee compensation arrangement was not self-dealing); I.R.S. Priv. Ltr. Rul. 8226149 (Apr. 5, 1982) (ruling that specific payments would not constitute self-dealing if not excessive). In contrast, payment of compensation to a disqualified person for non-personal services, such as custodial services provided by a corporation wholly owned by a foundation director, is subject to taxation notwithstanding the reasonableness of the compensation. *See* *Madden v. Comm’r*, 74 T.C.M. (CCH) 440, 449 (1997) (stating that payment of compensation for custodial services is subject to taxation notwithstanding reasonableness).

77. *See* Ellen P. Aprill, *Reconciling Nonprofit Self-Dealing Rules*, ABA REAL PROP. TR. & EST. L.J. (forthcoming 2014) (manuscript at 4–5, 7–23, 27–34) available at [http://papers.ssrn.com/sol3/papers.cfm?abstract\\_id=2327986](http://papers.ssrn.com/sol3/papers.cfm?abstract_id=2327986), archived at <http://perma.cc/X32X-A79X> (explaining and analyzing the self-dealing rules); Buckles, *supra* note 73, at 66–68 (providing an example in which compliance with state law does not shield the actor from the excise tax).

78. I.R.C. § 4945.

79. *See infra* notes 98–99 and accompanying text.

80. I.R.C. § 4945(d)(3)–(5). Section 170(c)(2)(B) refers to corporations, trusts, and community chests, funds, and foundations “organized and operated exclusively for religious, charitable, scientific, literary, or educational purposes.”

funds,<sup>81</sup> as well as with respect to their donors, advisors, and management.<sup>82</sup>

Public charities, too, now face a series of excise taxes on “excess benefit transactions.”<sup>83</sup> These taxes, too, mimic both the duty of loyalty<sup>84</sup> and the duty to administer the charity in accordance with its terms and governing law.<sup>85</sup> They apply to a whole range of transactions, including, for example, the payment of excessive compensation to a covered charity’s managers.<sup>86</sup> In particular, the recipient faces a tax equal to “25 percent of the excess benefit.”<sup>87</sup> If the transaction is not “corrected” in a timely fashion, the recipient faces an additional tax “equal to 200 percent of the excess benefit.”<sup>88</sup> In addition, “any organization manager [who participates] in the excess benefit transaction” faces a tax equal to “10 percent of the excess benefit,” unless the manager did not know that the transaction was an excess benefit transaction, the participation was “not willful,” or the participation was “due to reasonable cause.”<sup>89</sup>

Other excise taxes, also sometimes imposed at punishing rates, penalize not only self-dealing but a wide range of prohibited activities by charities, as well as transactions between charities and various groups of people that include, but often extend far beyond, the fiduciaries who run them. One such tax is the tax on “political expenditures.”<sup>90</sup> The statute defines political expenditures in language

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81. *Id.* § 4966.

82. *Id.* § 4967. Sections 4966 and 4967 were both enacted by the Pension Protection Act of 2006.

83. *Id.* § 4958. Section 4958 was enacted by the Taxpayer Bill of Rights 2 (1996).

84. See Buckles, *supra* note 73, at 82–87 (“The behavior of fiduciaries that is required to escape liability for payment of excise tax is similar, but not identical, to what one would expect of directors exercising their duties of loyalty and care under state law.”).

85. See Buckles, *supra* note 27, at 233–34 (describing incentives created by excise taxes). Perhaps this is just another way of saying that they also ensure that the charity actually dedicates its resources to the public benefit and enforce the federal rule against private inurement. See Darryll K. Jones, *The Scintilla of Individual Profit: In Search of Private Inurement and Excess Benefit*, 19 VA. TAX REV. 575, 639–49 (2000) (“It is difficult to know whether adoption of the phrase, ‘excess benefit transaction’ in section 4958 was intended to restate or redefine the law of private inurement.”); Jill S. Manny, *Nonprofit Payments to Insiders and Outsiders: Is the Sky the Limit?*, 76 FORDHAM L. REV. 735, 750–52 (2007) (discussing the prohibition against private inurement). Indeed, there are regulations as to when a charity’s tax exemption should be revoked for engaging in an excess benefit transaction. *E.g.*, Treas. Reg. § 1.501(c)(3)-1(f)(2)(ii) (2014).

86. I.R.C. § 4958(c)(1)(A).

87. *Id.* § 4958(a)(1).

88. *Id.* § 4958(b).

89. *Id.* § 4958(a)(2). “With respect to any 1 excess benefit transaction,” however, this tax cannot exceed \$20,000. *Id.* § 4958(d)(2).

90. *Id.* § 4955. Section 4955 was enacted by the Revenue Act of 1987.

virtually identical to that of section 501(c)(3), which has already essentially prohibited them: “any amount paid or incurred . . . in any participation in, or intervention in (including the publication or distribution of statements), any political campaign on behalf of (or in opposition to) any candidate for public office.”<sup>91</sup> Indeed, the tax applies only in the case of expenditures by a section 501(c)(3) entity.<sup>92</sup> The basic tax is relatively benign: it requires the charity to pay a tax equal to 10 percent of the amount of the expenditure;<sup>93</sup> it also requires management to pay a tax equal to 2.5 percent.<sup>94</sup> If, however, the expenditure is not “corrected” in a timely fashion, the tax on the charity rises to 100 percent of the amount of the expenditure,<sup>95</sup> and the tax on management rises to 50 percent.<sup>96</sup>

As we have already seen,<sup>97</sup> there is another tax on “taxable expenditures,”<sup>98</sup> which applies only to private foundations. As to these charities, the tax explicitly extends, subject to various exceptions, to any amount paid or incurred “to carry on propaganda, or otherwise to attempt, to influence legislation,” or “to influence the outcome of any specific public election, or to carry on, directly or indirectly, any voter registration drive.”<sup>99</sup> In the case of public charities, a special tax penalizes “excess expenditures to influence legislation.”<sup>100</sup> Congress seems so intent on at least pretending to want the IRS to police these sorts of activities that it has even enacted a tax on charities whose lobbying expenditures disqualify them from exemption under section 501(c)(3).<sup>101</sup>

It is true that, as to both campaigning and lobbying, state law has long been generally to the effect that such activities cannot

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91. *Id.* § 4955(d)(1).

92. *Id.* § 4955(a)(1).

93. *Id.*

94. *Id.* § 4955(a)(2). The tax on management applies, however, only to a manager who agreed to the expenditure. *Id.* Even then, it applies only if the manager’s agreement was “willful” and not “due to reasonable cause.” *Id.* In any event, the tax on management cannot exceed \$5,000 for “any 1 political expenditure.” *Id.* § 4955(c)(2).

95. *Id.* § 4955(b)(1).

96. *Id.* § 4955(b)(2). Here, too, the tax on management applies only to a manager who “refused to agree to part or all of the correction.” *Id.* Likewise, the tax on management for refusal to correct in a timely fashion cannot exceed \$10,000 for “any 1 political expenditure.” *Id.* § 4955(c)(2).

97. *See supra* notes 78–80 and accompanying text (discussing federal excise tax on “taxable expenditures”).

98. I.R.C. § 4945.

99. *Id.* § 4945(d)(1)–(2).

100. *Id.* § 4911. Section 4911 was enacted by the Tax Reform Act of 1976.

101. *Id.* § 4912. Section 4912 was enacted by the Economic Recovery Tax Act of 1981.

constitute the gist of an entity's charitable purpose.<sup>102</sup> Yet the lines in this area have always been fuzzy and at least certain kinds of rather hard-core advocacy seem by now to have won the stamp of charitable approval at the state level.<sup>103</sup> As between these state "rules" and the bristling federal arsenal threatening loss of tax exemption and disqualification to receive tax-deductible charitable contributions, as well as staggering excise taxes, it seems fair to say that federal law now dominates.

Other federal excise taxes mimic aspects of state law other than the duty of loyalty, although perhaps not intentionally. There is, for example, a federal excise tax on the "excess business holdings" of a private foundation.<sup>104</sup> It is possible that a charity's decision to acquire or retain a concentrated position in a certain business is the result of a violation of the duty of loyalty on the part of one or more of the charity's fiduciaries. This, however, is certainly not always the case. Instead, when a charity holds a concentrated investment position, it is far more likely to be merely a violation of the fiduciary's duty to invest as a prudent investor, i.e., a failure to diversify. Though the tax seems to have been enacted primarily as a way to limit charities' ability to engage directly in large-scale noncharitable business operations,<sup>105</sup> a clear by-product is to reinforce and/or to create a duty on the part of charitable fiduciaries to diversify their charitable portfolios.

There is another series of federal excise taxes on investments that "jeopardize" a private foundation's charitable purpose.<sup>106</sup> Yet another federal tax applies upon termination of private foundation status.<sup>107</sup> Both taxes mimic the state-law fiduciary duty to administer

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102. See RESTATEMENT (THIRD) OF TRUSTS § 28 cmt. l (2003) (promotion of a political party is not charitable); RESTATEMENT (SECOND) OF TRUSTS § 374 cmt. k (1959) (a trust to promote a political party is not charitable); 6 SCOTT, FRATCHER & ASCHER, *supra* note 1, §§ 38.7.8, 38.7.9 (noting that promoting a political party is not charitable but promoting legislation may be).

103. See, e.g., Dep't of Tex., *Veterans of Foreign Wars v. Tex. Lottery Comm'n*, 698 F.3d 239, 244 (5th Cir. 2012) ("The Commission has not pointed to any formal opinion in which it has interpreted the charitable purpose requirement as establishing a wholesale prohibition on political advocacy."); 6 SCOTT, FRATCHER & ASCHER, *supra* note 1, §§ 38.7.1 (temperance), 38.7.6 (unpopular causes), 38.7.8 (women's and minorities' causes), 38.7.9 (law reform). Interestingly, "the [federal] prohibition was not the product of a change in public opinion, but instead appears to have been proposed by [Senator Lyndon Baines] Johnson as a way to squelch certain unsavory campaign tactics targeted at him by a few tax-exempt entities." O'Daniel, *supra* note 54, at 740.

104. I.R.C. § 4943.

105. Legislative history indicates congressional concern that managing a large business enterprise might distract a charity's management from the charitable tasks at hand. See GENERAL EXPLANATION, *supra* note 64, pt. III.A.4, at 40–41 (giving examples in which business and non-charitable purposes predominated foundation activities).

106. I.R.C. § 4944.

107. *Id.* § 507.

a charity in accordance with its terms and applicable law, the duty of care or prudence, and the duty to control and protect the charity's property; in short, the duty to preserve a charity's ability to "do" charity.

And then there is the tax on "unrelated business income."<sup>108</sup> This is a tax on all income that a charity derives from any trade or business "the conduct of which is not substantially related (aside from the need of such organization for income or funds or the use it makes of the profits derived) to the exercise or performance by such organization of its charitable . . . purpose."<sup>109</sup> It was enacted in response to claims by tax-paying businesses of unfair competition by charities (e.g., when N.Y.U. owned Mueller Macaroni).<sup>110</sup> Under the regulations, a trade or business

is "related" to exempt purposes, in the relevant sense, only where the conduct of the business activities has causal relationship to the achievement of exempt purposes (other than through the production of income); and it is "substantially related," for purposes of section 513, only if the causal relationship is a substantial one.<sup>111</sup>

Examples of unrelated business income are catering services, condominium rentals, and advertising income. Thus, the unrelated business tax helps to ensure that the charity is fully committed to the accomplishment of charitable, rather than commercial, activity and to the accomplishment of its own particular charitable purpose.

A fascinating study dealing specifically with the unrelated business tax casts a very bright light on just how thoroughly federal tax law now permeates the administration of charities.<sup>112</sup> According to this study, certain nonprofits during the period 1995–1997 reported losses on their taxable activities in excess of \$1 billion, on \$4 billion of revenues.<sup>113</sup> In contrast, these same nonprofits reported profits in excess of \$50 billion on their tax-exempt activities. It seems safe to

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108. *Id.* §§ 511–515. The tax on unrelated business income was enacted in the Revenue Act of 1950.

109. *Id.* § 513(a). The IRS has ruled that the relevant charitable purpose must be that of the charity itself, not some other charitable purpose. Rev. Rul. 73-105, 1973-1 C.B. 264.

110. *See* H.R. REP. NO. 81-2319, pt. III, at 36 (1950) ("The problem at which the tax on unrelated business income is directed here is primarily that of unfair competition."); S. REP. NO. 81-2375, at 27 (1950) (explaining application of tax to unrelated business income); Susan Rose-Ackerman, *Unfair Competition and Corporate Income Taxation*, 34 STAN. L. REV. 1017, 1017–22 (1982) (describing the tax and fairness implications of N.Y.U.'s ownership of Mueller Macaroni).

111. Treas. Reg. § 1.513-1(d)(2) (1983).

112. Robert J. Yetman, *Tax-Motivated Expense Allocations by Nonprofit Organizations*, 76 ACCT. REV. 297, 309–10 (2001).

113. *Id.* at 298. Charities with unrelated business taxable income must file not only the regular Form 990 but also Form 990-T. Unlike the former, the latter is not subject to public disclosure. The author of the study, however, convinced 703 nonprofits to provide him with their Forms 990-T voluntarily. *Id.* at 300, 303.

assume that those running charities, like those running taxable businesses, would promptly jettison activities that consistently yielded losses—especially those that were not truly charitable and thus must have been undertaken primarily, or perhaps even exclusively, to generate revenues. These charities, however, at least according to their returns, kept throwing good money after bad at their “taxable” activities. Not surprisingly, the study concludes that what was actually going on was that these charities were allocating expenses from their tax-exempt activities to their taxable activities to reduce or eliminate the unrelated business tax.<sup>114</sup> We all know just how carefully most businesses consider tax consequences and adjust their behavior—or at least their accounting—to minimize them. It seems that in many instances charities that are subject to the unrelated business tax are no less amenable to “tax planning.”

Yet another federal excise tax imposes on private foundations certain annual minimum distribution requirements.<sup>115</sup> To avoid this tax, a private foundation must distribute annually at least five percent of the net fair market value of its investment assets for the accomplishment of purposes described in section 170(c)(2)(B).<sup>116</sup> If distributions fall short of this amount, the tax is equal to 30 percent of the shortfall.<sup>117</sup> If the shortfall remains unsatisfied until the earlier of the mailing of a notice of deficiency with respect to the tax or its

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114. The study makes no claim that these misallocations failed to comply with applicable tax law. Surely, however, any system that imposes a tax on “unrelated business income” ought not allow entities subject to the tax to evade it with impunity simply by reallocating expenses from tax-exempt activities to taxable activities. Part of the problem is a vague regulation that unhelpfully permits allocation of dual-use expenses on any “reasonable basis.” Treas. Reg. § 1.512(a)-1(c) (2002). In addition, at least one of the IRS’s own more specific positions has not found support in the courts. *Compare* I.R.S. Priv. Ltr. Rul. 9149006 (Aug. 12, 1991) (portion allocated to taxable income must be based on total availability for use), *with* *Rensselaer Polytechnic Inst. v. Comm’r*, 732 F.2d 1058, 1060–62 (2d Cir. 1984) (allocation may be based on actual use). Thus, it may be that expenses relating to a facility that mostly sits empty but that is occasionally used for the production of taxable income can “legitimately” be allocated disproportionately to the taxable income, notwithstanding the fact that the charity acquired the facility for its tax-exempt purposes, to which that facility is essential. It would seem, however, that one cannot fairly attribute these charities’ successes with tax-exempt activities and notable lack thereof with taxable activities solely to this particular glitch.

115. I.R.C. § 4942 (2012); *see generally* Johnny Rex Buckles, *Should the Private Foundation Excise Tax on Failure to Distribute Income Generally Apply to “Private Foundation Substitutes”?* *Evaluating the Taxation of Various Models of Charitable Entities*, 44 NEW ENG. L. REV. 493, 503–09 (2010) (explaining the state of current law).

116. I.R.C. § 4942(a), (c)–(e).

117. *Id.* § 4942(a). There is an exception for an “operating foundation.” *Id.* § 4942(a)(1). There is another exception when the failure is due to an error in the valuation of assets if the error “was not willful and was due to reasonable cause,” the failure is corrected in a timely fashion, and the private foundation notifies the IRS. *Id.* § 4942(a)(2).



assessment, the tax rises to one-hundred percent of the shortfall.<sup>118</sup> There is no similar excise tax on public charities.<sup>119</sup> Indeed, state law has rarely, if ever, required charities to pay out a certain amount each year.<sup>120</sup> Still, to be “charitable,” an entity must “do” charity. Some sort of distribution of funds, provision of goods or services, programming, dissemination of knowledge, or the like seems almost essential. Whether by intent or by accident, this particular tax thus encourages charities to behave like charities.

In sharp contrast, yet another federal excise tax imposes on private foundations a tax “equal to 2 percent of . . . net investment income.”<sup>121</sup> Taxing a charity on investment income seems directly contrary to encouraging it to “do” charity, at least on anything other than a very short-term basis. The sharp discontinuity of this particular tax with any substantive policy involving the regulation of charity no doubt lies in the fact that it was enacted simply as a way to pay for the costs of policing charities and charitable fiduciaries at the federal level.<sup>122</sup>

As if the number of excise taxes that may or may not intrude into the life of a charity were not sufficiently alarming, the rates at which they can apply are often frightening. Moreover, in certain instances the imposition of a tax would, all by itself, justify revocation of the charity’s tax-exempt status. Given these stakes, a number of states have enacted statutes that bar charities from engaging in any activity that would generate a federal excise tax.<sup>123</sup> It has been argued that the existence of potentially devastating taxes and the possibility of an effective death sentence by denial of federal tax-exempt status

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118. *Id.* § 4942(b), (j)(1).

119. See Buckles, *supra* note 27, at 232 (“[U]naffiliated public charities are not subject to a payout rule.”).

120. The entire thrust of current state law is to ensure that charities do not *overspend* and thereby impair their endowments. See UNIF. PRUDENT MGMT. OF INST. FUNDS ACT § 4(a) (2006) (“UPMIFA”) (subject to contrary settlor intent, charitable institution “*may* appropriate for expenditure or accumulate so much of an endowment fund as the institution determines is prudent” (emphasis added)); *id.* § 4(d) (“The appropriation for expenditure in any year of an amount greater than seven percent of the fair market value of an endowment fund . . . creates a rebuttable presumption of imprudence.”); *id.* § 4 cmt. (explaining purpose and scope of revisions). Virtually every state has enacted UPMIFA. See 5 SCOTT, FRATCHER & ASCHER, *supra* note 1, § 37.3.8 n.25 (5th ed. 2008 & Supp. 2013) (listing states that have enacted UPMIFA). See generally Johnny Rex Buckles, *Probing UPMIFA: The Mysteries of the Uniform Act in Light of Federal Tax and State Charity Laws and Concepts*, 46 REAL PROP. TR. & EST. L.J. 281, 282–85 (2011) (explaining the application of UPMIFA).

121. I.R.C. § 4940.

122. STAFF OF JOINT COMM. ON INTERNAL REVENUE TAXATION, 91ST CONG., GENERAL EXPLANATION OF THE TAX REFORM ACT OF 1969, at 29 (Comm. Print 1970).

123. *E.g.*, CAL. PROB. CODE § 16102 (West 2014); N.Y. EST. POWERS & TRUSTS LAW § 8-1.8 (McKinney 2014).

impair the ability of state attorneys general to do their jobs in enforcing charitable fiduciary obligations.<sup>124</sup> Certainly the extraction of taxes shifts to the federal government assets previously dedicated to charity, thereby limiting the ability of state attorneys general to obtain or even to seek damages or restitution.<sup>125</sup> Moreover, the taxes can apply to comparatively trivial sorts of self-dealing, or even to actions that would not be actionable under state law.<sup>126</sup> Given the fact that most state attorneys general have, to date, seen fit to commit virtually no resources to policing charities and their fiduciaries, whether any of these inconsistencies matters much is doubtful. The impression remains, however, that federal law is steadily crowding out state law.<sup>127</sup>

#### *D. Federal Collection and Dissemination of Information About Charities*

Surely the most frequently invasive, but perhaps also among the most effective, of the federal intrusions into the realm of regulating charity are the various annual reporting requirements. Forms 990 and 990-PF are neither easy nor quick to complete.<sup>128</sup> They demand—and reveal—detailed information about a charity's organizational structure, policies, transactions with related parties, salaries and other forms of employee benefits, fundraising expenses and overhead, engagement in lobbying or political campaign activities,

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124. See Buckles, *supra* note 40, at 691–92 (arguing that federal enforcement limits remedies available to state attorneys general).

125. *Id.* at 691.

126. See *id.* at 692–93 (private foundation termination tax may force “transfer of assets from a charitable entity to the federal government, notwithstanding that charity fiduciaries may have satisfied general state law standards of loyalty. . . . The IRS has the power to revoke the entity’s federal income tax exemption, even if the consequent income tax liability is vastly greater than the amount of private inurement involved.”).

127. See, e.g., PRINCIPLES OF THE LAW OF CHARITABLE NONPROFIT ORGS., *supra* note 11, § 130 cmt. e(1), illus. 6.

128. Form 990, for example, consists of twelve pages of very detailed questions. I.R.S. Form 990, Return of Organization Exempt from Income Tax (OMB No. 1545-0047) (2013). There is a shorter form, Form 990-EZ, currently available for certain charities with gross receipts of less than \$200,000 and total assets of less than \$500,000. It, too, is available to the public. Certain charities with gross receipts of less than \$50,000 may file an annual electronic notice, Form 990-N, an e-Postcard. See INTERNAL REVENUE SERVICE, CAT. NO. 64888C, 2013 INSTRUCTIONS FOR FORM 990-EZ 1–2 (2013). For some charities there is no filing requirement. I.R.C. § 6033(a)(3)(A) (2012) (exempting churches, organizations whose gross annual receipts normally do not exceed \$5,000, and exclusively religious activities of religious orders). See generally John Montague, *The Law and Financial Transparency in Churches: Reconsidering the Form 990 Exemption*, 35 CARDOZO L. REV. 203 (2013).

and ownership of conservation easements.<sup>129</sup> This information not only goes to the IRS<sup>130</sup> but also is readily available to the public.<sup>131</sup> The application for exemption, Form 1023, is itself available to the public.<sup>132</sup> It seems hard to believe that having to answer such specific questions publicly would not affect charities' primary behavior, even in ways that they believe are not necessarily in their own best interests.<sup>133</sup>

As the primary receptacle of all sorts of returns and other information filed by charities nationwide, the federal government is in a prime position to help the states enforce their own laws by sharing information. Unfortunately, much of what the federal government has actually done seems, in fact, to have *limited* the ability of state officials to obtain such information.<sup>134</sup>

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129. Unsurprisingly, the IRS has a "Governance Check Sheet" for use by its revenue agents in examining section 501(c)(3) charities. INTERNAL REVENUE SERVICE, CAT. NO. 54282M, FORM 14114 (2009). This check sheet is incredibly demanding—and intrusive—asking, among many other things, how often a quorum of voting members met; whether the authorized body relied on comparability data in making compensation determinations; whether disclosed conflicts of interest were handled in accordance with the organization's written conflict of interest policy; whether the full board reviewed the Form 990; whether an independent accountant's report was prepared and reviewed by the full board; and whether the organization has and adheres to a written policy for document retention and destruction. *Id.*

130. I.R.C. § 6033(a)(1).

131. *Id.* § 6104(d)(1); Treas. Reg. § 301.6104(d)-1(a) (as amended in 2003). GuideStar, at <http://www.guidestar.org>, and Urban Institute National Center for Charitable Statistics, <http://nccs.urban.org>, provide easy public access to these filings. See Brody, *Sunshine and Shadows*, *supra* note 37, at 206 (noting the profound impact of these organizations on public access to charity tax reporting). Filed forms are also available from the IRS. *Id.*

132. I.R.C. § 6104(a)(1)(A).

133. See, e.g., ADVISORY COMM. ON TAX EXEMPT AND GOV'T ENTITIES, THE APPROPRIATE ROLE OF THE INTERNAL REVENUE SERVICE WITH RESPECT TO TAX-EXEMPT ORGANIZATION GOOD GOVERNANCE ISSUES 38 (2008), available at [http://www.irs.gov/pub/irs-tege/tege\\_act\\_rpt7.pdf](http://www.irs.gov/pub/irs-tege/tege_act_rpt7.pdf), archived at <http://perma.cc/S5YV-PZUB> (suggesting that the wording of questions in publicly available forms causes charities to adopt practices allowing them to give favorable answers to those questions, even when the practices are inappropriate for their own situations). There is, however, some evidence that certain types of data reported on these forms are pervasively incorrect. At least two studies have found, for example, that charities widely underreport their fundraising expenses. Elizabeth K. Keating, Linda M. Parsons & Andrea Alston Roberts, *Misreporting Fundraising: How Do Nonprofit Organizations Account for Telemarketing Campaigns?*, 83 ACCT. REV. 417, 419 (2008); Ranjani Krishnan, Michelle H. Yetman & Robert J. Yetman, *Expense Misreporting in Nonprofit Organizations*, 81 ACCT. REV. 399, 401 (2006); see also William P. Barrett, *Charities Fudge Their Fundraising Costs? Shocking!*, FORBES (Feb. 22, 2012, 1:14 PM), <http://www.forbes.com/sites/williambarrett/2012/02/22/charities-fudge-their-fundraising-costs-shocking>, archived at <http://perma.cc/V7KC-RQM8> (noting that many charities regularly hide politically unappealing costs through dubious accounting practices).

134. See PRINCIPLES OF THE LAW OF CHARITABLE NONPROFIT ORGS., *supra* note 11, § 130 cmt. e(2) (noting federal privacy constraints on I.R.S. information sharing and stating that efforts to improve information sharing have made slow progress); NAT'L ASS'N OF STATE CHARITY OFFICIALS, COMMENTS TO PROPOSED REGULATIONS NUMBER REG-140108-08, at 2 (2011), available at [http://www.charitableplanning.com/cpc\\_1827385-1.pdf](http://www.charitableplanning.com/cpc_1827385-1.pdf), archived at <http://>

*E. Federal "Education"*

The federal impact on state enforcement of charities and their fiduciaries is not limited to the passage of laws, the imposition of taxes, and the promulgation of regulations that effectively supersede state laws seeking to achieve roughly the same objectives. The IRS has also undertaken a massive role in "educating" charities and those who run them. Indeed, it has been noted that "[t]he role of the Internal Revenue Service with respect to charities is an anomaly within the agency, whose overall function is to ensure that taxpayers pay the taxes they owe."<sup>135</sup> Nor does the IRS limit itself to guidance on what forms to file and when and how to file them. The IRS website has a page specifically dedicated to charities.<sup>136</sup> A document entitled "Governance and Related Topics—501(c)(3) Organizations" offers specific suggestions as to how a charity should develop its mission; what its organizational documents, governing body, and financial statements should look like; what sorts of governance and management policies it should have; and how it should deal with transparency and accountability when keeping minutes, making investments, and handling whistleblowers.<sup>137</sup> The forms themselves demand vastly more information than the IRS needs, strictly speaking, to do its job.<sup>138</sup> Even when it requests clearly required information, the IRS educates charities and those who run them about

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perma.cc/YW3K-WKKD (noting that the Pension Protection Act (2006) imposed further restrictions on information-sharing between the I.R.S. and state governments).

135. PRINCIPLES OF THE LAW OF NONPROFIT ORGS. § 620 cmt. a (Tentative Draft No. 3, 2011).

136. *Tax Information for Charities & Other Non-Profits*, INTERNAL REVENUE SERVICE, <http://www.irs.gov/Charities-&-Non-Profits>, archived at <http://perma.cc/D5H2-H8LZ> (last updated Sept. 9, 2014).

137. *Governance and Related Topics—501(c)(3) Organizations*, INTERNAL REVENUE SERVICE (Feb. 4, 2008), [http://www.irs.gov/pub/irs-tege/governance\\_practices.pdf](http://www.irs.gov/pub/irs-tege/governance_practices.pdf), archived at <http://perma.cc/S3PV-EVPD>.

138. See *Exempt Organizations Annual Reporting Requirements—Governance (Form 990, Part VI)*, INTERNAL REVENUE SERVICE, [http://www.irs.gov/Charities-&-Non-Profits/Exempt-Organizations-Annual-Reporting-Requirements-Governance-\(Form-990,-Part-VI\)](http://www.irs.gov/Charities-&-Non-Profits/Exempt-Organizations-Annual-Reporting-Requirements-Governance-(Form-990,-Part-VI)), archived at <http://perma.cc/8F4Z-373U> (last updated May 13, 2014) (stating that although the policies and practices required by Section VI of Form 990 are not required by law, organizations are nonetheless required to answer all questions). The Frequently Asked Questions section of the IRS nonprofit webpage explicitly acknowledges that many of the governance questions in Part VI of Form 990 go well beyond actual statutory requirements. *Id.* Possible examples include: "Did the organization contemporaneously document the meetings held or written actions undertaken during the year by [t]he governing body?"; "Did the organization have a written whistleblower policy?"; and "Did the organization have a written document retention and destruction policy?" I.R.S. Form 990, Return of Organization Exempt from Income Tax, pt. VI (OMB No. 1545-0047) (2013).

how they are “supposed to” behave, at least if they want, as most taxpayers do, to take the path of least resistance with the IRS.

#### IV. DEVICES FOR THE BENEFIT OF CHARITY

Professor Scott attributed the survival of trusts and, more generally, their ubiquity to their flexibility.<sup>139</sup> That flexibility continues to this day under state law, perhaps to an even greater extent than ever before. Federal tax law, however, severely limits the options of a donor who wishes to split the beneficial interest in a trust between charity and private parties, ordinarily family members. Under federal tax law, only a favored few types of trusts entitle such a donor to the full fruits of his or her philanthropy, i.e., tax deductions. These days, such a donor must utilize one or more of only five hothouse hybrids never previously known to humankind, and to this day known only to federal tax cognoscenti. According to the Internal Revenue Code, the only currently acceptable options are: (1) a charitable remainder annuity trust (“CRAT”), (2) a charitable remainder unitrust (“CRUT”), (3) a pooled income fund (“PIF”), (4) a charitable lead annuity trust (“CLAT”), or (5) a charitable lead unitrust (“CLUT”).<sup>140</sup> Anything else would result in at least two tax disasters: (1) no income tax deduction—not even for the value of the portion of the trust irrevocably committed to charity—and (2) no transfer tax deduction, meaning that the donor would be required to pay an “excise tax” for the privilege of benefitting charity via a device not approved of by federal law, or at least that the donor would squander a portion of his or her unified credit equivalent.

There are numerous consequences. Planning for philanthropy is now straitjacketed by federal tax law. Those who cannot or do not want to benefit charity through outright transfers or the creation of purely charitable trusts must find their way through the eye of the federal tax needle. This has given birth to an entirely new estate planning subspecialty: enabling, planning, correcting, and undoing split-interest charitable trusts.

One of the hothouse hybrids, the PIF, requires charities, or at least those many charities that choose not to exclude themselves from the possibility of receiving funding via a PIF, to establish and maintain one or more of their own. This requires charities to add staff

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139. See 1 SCOTT, FRATCHER & ASCHER, *supra* note 1, § 1.1 (5th ed. 2006).

140. See I.R.C. §§ 170(f)(2)(A), 2055(e)(2), 2522(c)(2) (2012) (providing deductions for income, estate, and gift taxes, respectively).

and/or hire yet more lawyers and accountants. This is simply another cost, imposed by the federal government, of being a charity.

The rules regarding what qualifies as a permissible split-interest charitable trust are mind-numbingly complex. No doubt the law is full of complexity, but the split-interest rules are so complex that the stereotypical general practitioner, even with a passing knowledge of wills and trusts, often seems unable to ensure qualification under the federal tax rules. Thus, the cases involving badly conceived or badly designed split-interest charitable trusts continue to pile up. In the interest of “saving taxes,” courts have become all too willing to torture perfectly clear language and to presume intentions for which there is absolutely no evidence.<sup>141</sup> Virtually every state now has legislation authorizing trust reformation to save taxes generally,<sup>142</sup> and many have statutes aimed directly at salvaging either the charitable deduction or split-interest charitable trusts.<sup>143</sup>

Most of those who have ever been confined to a straitjacket have eventually concluded that they would rather not be. So also here: many of both the charities and the private parties who have found themselves constrained by the straitjackets of federally approved split-interest trusts have eventually concluded that they would rather take their marbles and go home. Thus, a cottage industry now concerns itself with extracting beneficiaries from split-interest trusts, or at least making their confinement less odious, while ensuring them that the tax consequences of their new-found freedom or flexibility remain tolerable.<sup>144</sup>

Again, however, the claim here is not that the federal tax rules relating to split-interest trusts are bad, unjustified, or even unnecessarily intrusive on state prerogatives. The split-interest rules were yet another part of the Tax Reform Act of 1969. With them,

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141. See 5 SCOTT, FRATCHER & ASCHER, *supra* note 1, § 33.5 (5th ed. 2008) (discussing cases in which courts have allowed postmortem restructuring of trusts to achieve more favorable taxation, despite such trusts' having been properly structured to match settlors' apparent intentions).

142. See, e.g., UNIF. TRUST CODE § 416 (“To achieve the settlor’s tax objectives, the court may modify the terms of a trust in a manner that is not contrary to the settlor’s probable intention.”); see also RESTATEMENT (THIRD) OF PROP.: WILLS AND DONATIVE TRANSFERS § 12.2 (2003) (“A donative document may be modified, in a manner that does not violate the donor’s probable intention, to achieve the donor’s tax objectives.”).

143. See 5 SCOTT, FRATCHER & ASCHER, *supra* note 1, § 33.5 nn. 20–21 (5th ed. 2008) (cataloging state statutory provisions for salvaging charitable deductions generally and split-interest trusts in particular).

144. See M. CARR FERGUSON, JAMES J. FREELAND & MARK L. ASCHER, FEDERAL INCOME TAXATION OF ESTATES, TRUSTS & BENEFICIARIES §§ 11.02[A] n.17, 11.03[A] n.18, 12.04 (3d ed. 1999 & Supp. 2014).

Congress deliberately sought to correct a perceived and, one can only imagine, real abuse under state law.<sup>145</sup> The poster child that launched the split-interest rules was: “Income to Wife for life, remainder to the University of Texas; Wife to serve as trustee.” The self-interested beneficiary/trustee would then stack or otherwise mismanage investments and/or payouts in such a way as to favor herself, sometimes grotesquely. With no one minding the store at the state attorney general’s office, she would inevitably get away with it; the University of Texas would end up holding an essentially empty bag; and the federal government, having allowed at least one tax deduction upon the creation of the trust for the supposed value of the charitable remainder, would have substantially overpaid for what little remained for the University of Texas. In 1969, Congress decided that it had lost enough tax revenue in this way and took action more or less reasonably designed to address the problem.<sup>146</sup> The end result, however, is that, by effectively eliminating the simpler sorts of devices that fiduciaries once often abused, the split-interest rules are yet another, albeit indirect, layer of federal regulation of both the fiduciary duty of loyalty and the fiduciary duty of impartiality. In addition, the split-interest rules have indisputably made the field of charitable giving vastly more complex and expensive.

## V. CONSERVATION EASEMENTS

Although hardly at the center of either charity or charitable giving, conservation easements, too, are beginning to leave their own indelible impressions on the law of charity. In addition to the five hothouse hybrid trusts already discussed, there is another way to obtain federal tax deductions for gifts to charity in which private parties share an interest: carving out a conservation easement for charity,<sup>147</sup> such as the right to block all or certain types of development on the subservient property. Such an easement must be “exclusively for conservation purposes” and “granted in perpetuity.”<sup>148</sup>

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145. See STAFF OF JOINT COMM. ON INTERNAL REVENUE TAXATION, 91ST CONG., *supra* note 122, at 83–84 (stating that the Act changed the law to prevent charitable contribution deductions far exceeding the actual value of remainders going to charity).

146. *Id.*

147. I.R.C. § 170(f)(3)(B)(iii) (2012). For excellent analysis of conservation easements, see Nancy A. McLaughlin, *Internal Revenue Code Section 170(h): National Perpetuity Standards for Federally Subsidized Conservation Easements, Part 1: The Standards*, 45 REAL PROP. TR. & EST. L.J. 473 (2010), and Nancy A. McLaughlin, *Internal Revenue Code Section 170(h): National Perpetuity Standards for Federally Subsidized Conservation Easements, Part 2: Comparison to State Law*, 46 REAL PROP. TR. & EST. L.J. 1 (2011).

148. I.R.C. § 170(h)(1)(C), (2)(C).

The relevant statute is unequivocal, if also repetitive, in the latter regard: “A contribution shall not be treated as exclusively for conservation purposes unless the conservation purpose is protected in perpetuity.”<sup>149</sup> In addition, the easement must bar “extraction or removal of minerals by any surface mining method.”<sup>150</sup>

Perhaps it is obvious, but these are seriously—perhaps even extremely—demanding requirements. And there are good reasons why they should be. First, the intent of both the federal government and, presumably, the person granting the easement is that it be *effective* in preserving the current state of the land or building in question.<sup>151</sup> Second, by granting deductions for the amount by which the easement supposedly decreases the property’s fair market value, to say nothing of the additional estate tax exclusion,<sup>152</sup> the federal government in effect pays for a substantial portion of the easement.<sup>153</sup>

In the case of buildings in registered historic districts, the statute itself seeks to provide additional assurance of enforcement, according to the easement’s terms, by requiring that the donee organization have “a purpose of environmental protection, land conservation, open space preservation, or historic preservation” and that it have “the resources to manage and enforce the restriction and a commitment to do so.”<sup>154</sup> The regulations seemingly extend the latter requirement to donations of all conservation easements by defining an “eligible donee” as an entity that has both the “commitment to protect the conservation purposes of the donation” and “the resources to enforce the restrictions.”<sup>155</sup> Any charity that allows modification of an easement in such a way as to increase the value of the subservient property (if held by a private party) without receiving in exchange

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149. *Id.* § 170(h)(5)(A); *see also* Treas. Reg. § 1.170A-14(a) (as amended in 2009); Wachter v. Commissioner, 142 T.C. No. 7 (2014) (holding that an easement failed to qualify for federal tax purposes because North Dakota law limited it to 99 years).

150. I.R.C. § 170(h)(5)(B)(i). There is, however, an exception when the mineral rights have already been separated from the ownership of the surface estate and the probability of surface mining actually occurring on the property is so remote as to be negligible. *Id.* § 170(h)(5)(B)(ii).

151. *See* Ann Taylor Schwing, *Perpetuity Is Forever, Almost Always: Why It Is Wrong to Promote Amendment and Termination of Perpetual Conservation Easements*, 37 HARV. ENVTL. L. REV. 217, 235 (2013) (“Federal tax law mandates that recipients of federal tax-deductible conservation easements must have a commitment to protect the conservation purpose . . . and the resources to enforce them.”).

152. I.R.C. § 2031(c).

153. *See* Roger Colinvaux, *The Conservation Easement Tax Expenditure: In Search of Conservation Value*, 37 COLUM. J. ENVTL. L. 1, 9–10 (2012) (estimating revenue loss of \$3.6 billion from federal income tax deductions for individual conservation easement donors during the period 2003–2008).

154. I.R.C. § 170(h)(4)(B)(ii).

155. Treas. Reg. § 1.170A-14(c)(1) (as amended in 2009).



consideration of at least equal value fails to carry out the charitable purpose for which it claims tax exemption and almost certainly runs afoul of either the rule against private inurement or the rule against private benefit.<sup>156</sup> It may as well subject itself to personal liability for breach of trust under state law.

All easements, but especially these easements, are *supposed to be* straitjackets. So it is hardly surprising that subsequent owners, and sometimes even the donors themselves, would seek to escape their restraints. To curb one obvious sort of abuse, the regulations explicitly bar the transfer of a conservation easement, for consideration or not, except to another qualified holder that agrees to continue to enforce it.<sup>157</sup> In addition, there are good reasons to believe that the courts will think of conservation easements as a species of charitable trust.<sup>158</sup> Indeed, the regulations require that conservation easements only be extinguishable in what amounts, for all practical purposes, to a judicial cy pres proceeding:

If a subsequent unexpected change in the conditions surrounding the property . . . can make impossible or impractical the continued use of the property for conservation purposes, the conservation purpose can nonetheless be treated as protected in

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156. See I.R.S. Priv. Ltr. Rul. 201110020 (Mar. 11, 2011) (revoking exemption of organization that accepted conservation easements, failed to monitor and enforce them, and permitted amendment of at least one); INTERNAL REVENUE SERVICE, CAT. NO. 51527M, FORM 990 SCHEDULE D INSTRUCTIONS 2 (2013) (stating that tax-exempt status may be “undermined” if easements have been amended in any way); INTERNAL REVENUE SERVICE, CONSERVATION EASEMENT AUDIT TECHNIQUES GUIDE 50–51 (2012) (requiring reduction of amount of contribution by any increase in the value of the landowner’s other properties resulting from conservation easement); Nancy A. McLaughlin & Benjamin Machlis, *Amending and Terminating Perpetual Conservation Easements*, PROB. & PROP., July–Aug. 2009, at 52, 55 (noting that an organization that allows amendment of an easement in a way that increases the value of the servient estate, and thereby confers a benefit on its owner, would likely lose tax-exempt status).

157. Treas. Reg. § 1.170A-14(c)(2).

158. See UNIF. TRUST CODE § 414 cmt. (amended 2004) (“Even though not accompanied by the usual trappings of a trust, the creation and transfer of an easement for conservation or preservation will frequently create a charitable trust.”); RESTATEMENT (THIRD) OF TRUSTS § 28 cmt. a (2003) (“[C]ourts prefer to find that a purpose is limited to charity . . . when uncertain language is susceptible of a broader, not strictly charitable interpretation.”); RESTATEMENT (THIRD) OF PROP.: SERVITUDES § 7.11 (2000) (stating that cy pres governs modification and termination of conservation easements if their intended purpose becomes impracticable); Nancy A. McLaughlin, *Extinguishing and Amending Tax-Deductible Conservation Easements: Protecting the Federal Investment After Carpenter, Simmons, and Kaufman*, 13 FLA. TAX REV. 217, 235–36 (2012) (stating that courts are likely to interpret conservation easements to achieve their charitable purposes); McLaughlin & Machlis, *supra* note 156, at 52–53 (“A number of sources indicate that tax-deductible conservation easements will be treated as charitable trusts under state law.”); Nancy A. McLaughlin & W. William Weeks, Hicks v. Dowd, *Conservation Easements and the Charitable Trust Doctrine: Setting the Record Straight*, 10 WYO. L. REV. 73, 76 (2010) (arguing that restricted gifts should be treated substantively as charitable trusts). *But see* Carpenter v. Comm’r, 103 T.C.M. (CCH) 1001 (2012) (holding that a conservation easement, although a restricted gift, was not a charitable trust).

perpetuity if the restrictions are extinguished by judicial proceeding and all of the donee's proceeds . . . from a subsequent sale or exchange of the property are used by the donee organization in a manner consistent with the conservation purposes of the original contribution.<sup>159</sup>

To date, the state courts that have taken up the issue have generally proceeded in essentially this way.<sup>160</sup> It strikes this author, however, that, no matter how tightly the regulations seek to link the underlying federal tax inquiry to the traditional rules relating to cy pres, the two scenarios are often likely to involve substantially different fact patterns.

In the traditional cy pres case, something has usually gone quite “wrong,” making accomplishment of the initial charitable purpose *impossible*, or practically so. A will creates a trust to promote the elimination of slavery, for example, and promptly thereafter a Civil War occurs, a President issues an Emancipation Proclamation, and an amendment to the Constitution eliminates slavery once and for all.<sup>161</sup> Or a will creates a public park “for the sole, perpetual and unending, use, benefit and enjoyment of the white women, white girls, white boys and white children of the City of Macon,” and the Supreme Court of the United States, interpreting another provision of the Constitution, concludes that neither the city nor the private trustees to whom it has handed off responsibility for operating the park can continue to do so on a discriminatory basis.<sup>162</sup> These are cases in which the particular charitable purpose involved has simply become unworkable. Not all cy pres cases are precisely this abrupt, but most are not much less so: a testator leaves an amount that pales in comparison with that necessary to accomplish a particular purpose;<sup>163</sup>

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159. Treas. Reg. § 1.170A-14(g)(6)(i); *see also* *Carpenter*, 103 T.C.M. at 1001 (noting that if the easement had been extinguishable only by cy pres, it would have met the perpetuity requirement and been tax-deductible, despite being a restricted gift rather than a charitable trust); *Kaufman v. Comm’r*, 136 T.C. 294, 307 (2011) (referring to the regulation as a “regulatory version of the doctrine of cy pres”), *vacated in part on other grounds*, 687 F.3d 21 (1st Cir. 2012); 1982 East, LLC v. Comm’r, 101 T.C.M. 1380 (2011) (citing the regulation).

160. *See* Complaint for Declaratory Relief, Att’y Gen. v. Miller, No. 20-C-98-003486, 1998 WL 35318061 (Md. Cir. Ct. July 9, 1998) (complaint seeking enforcement of conservation easement against landowners seeking to subdivide); *In re Pres. Alliance for Greater Phila.*, O.C. No. 759 (C.P. Phila. Cnty., Pa. June 28, 1999) (granting extinguishment of façade easement); *Tenn. Env’tl. Council v. Bright Par 3 Assocs.*, No. 03-0775 (Ch. Ct. Hamilton Cnty., Tenn. Dec. 19, 2006); *Hicks v. Dowd*, 157 P.3d 914 (Wyo. 2007), *later proceeding*, *Salzburg v. Dowd*, Civ. No. CV-2008-0079 (Wyo. Jud. Dist. Ct. Feb. 17, 2010). *But see* *Walters & Otero Cnty. Land Trust*, No. 05-CV-96 (Colo. Dist. Ct. June 21, 2005) (order terminating easements in uncontested litigation); *Bjork v. Draper*, 936 N.E.2d 763 (Ill. App. Ct. 2010) (enforcing easement according to its terms but not engaging in cy pres analysis).

161. *Jackson v. Phillips*, 96 Mass. (14 Allen) 539, 546 (1867).

162. *Evans v. Abney*, 396 U.S. 435 (1970); *Evans v. Newton*, 382 U.S. 296 (1966).

163. *In re Estate of Thompson*, 414 A.2d 881, 884 (Me. 1980).

an indispensable third party refuses to participate;<sup>164</sup> or a named charity ceases to exist.<sup>165</sup> These are all situations in which there is no doubt that a major impediment to the continuation of the trust has arisen. Nor is the impediment something the trustee and one or more others have gotten together and instigated and/or negotiated. There is simply an impasse caused by outside forces.<sup>166</sup>

One cannot help but suspect that the typical fare of attempts to wriggle free from the straitjacket of a conservation easement will be very different. An estimated forty million acres are now subject to perpetual conservation easements in this country.<sup>167</sup> This alone means that the collisions between conservation easements and the perceived need for flexibility to meet real or imagined changes will be myriad. And the public pressure to respond to these supposed changes will often be vastly more intense than that which surfaces in the typical cy pres hearing. A mining or energy enterprise, for example, will discover commercially attractive resources on or under the land and offer a king's ransom to buy out the charity's easement; the local (or perhaps even national) community will clamor for the project to proceed; and the charity will salve its own conscience (as the regulations require) by promising to devote the replacement treasures to similar conservation purposes. Or a governmental unit will conclude that that it has a "better" use for the land in question and threaten to resort to eminent domain, and the charity, after negotiations, will conclude that a swap for other land (or an easement on other land) will sufficiently serve the conservation purposes. Or, over time, the lands surrounding the subservient lands will change so dramatically that the charity eventually decides simply to throw in the towel—for lucrative consideration, of course. The almighty dollar, the governmental and bureaucratic lust for additional facilities, and/or public pressure will often prove "irresistible."<sup>168</sup>

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164. *Weninger Estate v. Canadian Diabetes Ass'n* (1993), 109 D.L.R. 4th 232 (Can. Ont. Sup. Ct. J.).

165. *Simmons v. Parson Coll.*, 256 N.W.2d 225, 226–27 (Iowa 1977).

166. It is true that shades of gray occasionally emerge in litigation purporting to involve cy pres. See, e.g., Homer B. Thompson, Opinion, *In the Matter of the Estate of Beryl H. Buck*, reprinted in 21 U.S.F. L. REV. 691, 749 (1987) ("Neither inefficiency nor ineffective philanthropy constitute impracticability."). To date, however, such cases have been the exception and not the rule.

167. Jessica E. Jay, *Understanding When Perpetual Is Not Forever: An Update to the Challenge of Changing Conditions, Amendment, and Termination of Perpetual Conservation Easements, and Response to Ann Taylor Schwing*, 37 HARV. ENVTL. L. REV. 247, 247 n.1 (2013).

168. Or the owner of the subservient land will simply find the restrictions irksome and ask the charity to relieve him or her of them. In *Bjork v. Draper*, 886 N.E.2d 563 (Ill. App. Ct.), appeal denied, 897 N.E.2d 249 (Ill. 2008), for example, a new owner wished to build an addition to a house and expand a driveway in violation of a conservation easement and agreed with the

In none of these instances, however, is continuation of the initial charitable purpose of the easement impossible—or anything like it. Continuation is simply, or perhaps only arguably, inconvenient to one or more third parties and/or certain elements of the public at large who would prefer to put the land to what they regard as a better—likely more profitable—use. And the fact that the regulations *require* that any consideration received in exchange for the failed conservation easement be applied by the charity to a similar conservation purpose means that the courts will feel somewhat—or perhaps even substantially—more willing to find a significant change in circumstances than in the case of traditional cy pres, because in traditional cy pres analysis, one possible outcome is that the property *returns to the private party who created the trust (or his or her estate)*.<sup>169</sup>

Moreover, in the usual cy pres case, “all” that is at stake is money—or fungible investment assets. If the parties and/or the court choose to hew closely to the settlor’s original intent, there are very few with any real dog in the fight. One charity may feel slighted, perhaps another charity will benefit, or perhaps the settlor’s family was simply hoping for a windfall. Regardless of the outcome, almost no one other than the parties themselves ends up with any reason to feel harmed, and one might well wonder how harmed even the parties themselves are entitled to feel. But modifying or eliminating a conservation easement, which by definition deals exclusively with the most unique of all forms of property, real property,<sup>170</sup> has the potential to affect large numbers of others.

*Colonial Trust Co. v. Brown*<sup>171</sup> is perhaps more predictive of how the courts will react to this sort of litigation than the typical cy pres proceeding. A testator created a trust and funded it with real property located in the heart of downtown Waterbury, Connecticut.<sup>172</sup> His will barred the trustee from entering into leases longer than one year and from erecting new buildings more than three stories high.<sup>173</sup> The hoped-for effect, obviously, was much like that of a modern-day conservation easement. But when the trustee found the restrictions irksome, the court was, one might suggest, all too willing to eliminate

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charity to add additional land of equivalent size to the easement in return. In this instance, the court refused to approve the swap. *Id.* at 574.

169. See RESTATEMENT (THIRD) OF TRUSTS § 67 & cmt. b (2003); RESTATEMENT (SECOND) OF TRUSTS § 399 & cmt. c (1959).

170. I.R.C. § 170(h) (2012).

171. 135 A. 555 (Conn. 1926).

172. *Id.* at 558.

173. *Id.*

them. Ordinarily, settlors are free to impose virtually any restriction they wish on their trustees' conduct.<sup>174</sup> Here, however, the court referred expressly to "public policy" and alluded vaguely to the adverse effects that such restrictions might have on neighboring properties and even the community at large.<sup>175</sup> Note, as well, that this was a purely private trust, the duration of which was strictly limited by the Rule Against Perpetuities<sup>176</sup>—not a charitable trust explicitly designed, and required, to last "in perpetuity." If the court in this case was unabashedly impatient with a purely temporary restriction on a few buildings in a small town, think how impatient another court might someday become with a "perpetual" restriction on tens or hundreds of thousands of acres of "empty" land sitting on vast energy reserves, or even a few acres of wetlands impeding the development of a new residential, commercial, industrial, military, or other governmental project for which popular support was strong.

It is true that the regulations require a "judicial proceeding" to extinguish a conservation easement.<sup>177</sup> So the charity is not completely free to wheel and deal; it cannot, for example, simply swap one easement for another or for money.<sup>178</sup> The key word in the regulation may therefore be "impracticable." It is an exceedingly capacious word. Litigants will continuously mouth it, and result-oriented judges may seek to hide behind its billowing skirts. It is also, however, a word that has long appeared in black-letter restatements of the law of trusts,<sup>179</sup> and, to date, its capaciousness has not come to dominate cy pres doctrine or rotted away the lodestar of trust law, i.e., fidelity to donor intent. Still, one cannot help but wonder whether the inevitable litigation over the stickiness of conservation easements, which in both what they control and their potential for spill-over

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174. *Id.* at 564 (quoting *Holmes v. Conn. Trust & Safe Deposit Co.*, 103 A. 640, 642 (Conn. 1918)).

175. *Id.* at 567 (Wheeler, C.J., concurring).

176. *Id.* at 560.

177. Treas. Reg. § 1.170A-14(g)(6)(i) (as amended in 2009).

178. See *Belk v. Comm'r*, 105 T.C.M. (CCH) 1878 (2013) (denying deductions for easements that permitted trustee to swap land covered by the easement); *Carpenter v. Comm'r*, 103 T.C.M. (CCH) 1001 (2012) (denying deductions for easements that permitted donee to consent to extinguish them), *reconsideration denied*, 106 T.C.M. (CCH) 62 (2013); I.R.S. Chief Couns. Adv. Mem. 2012-0017 (Mar. 5, 2012). *But see* *Comm'r v. Simmons*, 646 F.3d 6 (D.C. Cir. 2011) (allowing deductions for easements that permitted donee to consent to changes or to abandon easement).

179. *E.g.*, RESTATEMENT (THIRD) OF TRUSTS § 67 (2003); RESTATEMENT (SECOND) OF TRUSTS § 399 (1959).

effects are demonstrably very different from the usual charitable trust, will be similarly respectful of current cy pres doctrine.<sup>180</sup>

## VI. MISCELLANEOUS FEDERAL INTRUSIONS INTO THE LAW OF CHARITY

In the not-so-distant past, many states had legislation limiting the size or timing of bequests to charity.<sup>181</sup> These limitations have since almost entirely disappeared, in part due to concerns about their constitutionality.<sup>182</sup>

Many states have sought to regulate charitable fundraising. But a series of federal cases have effectively gutted those efforts.<sup>183</sup> Nor, in this instance, has the federal government stepped in to fill the void. The Federal Trade Commission, for example, has jurisdiction over only those interstate charitable solicitations that are engaged in by for-profit solicitors.<sup>184</sup> There is other, miscellaneous federal oversight of various aspects of charitable fundraising,<sup>185</sup> but it seems fair to say that much of the field is now essentially unregulated.

Many states now have statutes that give trustees and/or executors extensive powers to deal with potential liabilities under the federal environmental laws.<sup>186</sup> These statutes are not, of course, aimed directly at charities, charitable bequests, or charitable trusts, but they can affect them dramatically.

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180. For a thoroughly optimistic view thoughtfully dismissing such concerns, see Nancy A. McLaughlin & W. William Weeks, *In Defense of Conservation Easements: A Response to The End of Perpetuity*, 9 WYO. L. REV. 1, 69–74 (2009). In fact, there seems to be an ongoing full-throated debate involving exactly the sorts of questions I have posed here, i.e., just how “perpetual” *can* conservation easements actually be? Compare, e.g., Jay, *supra* note 167 (arguing for clearer guidance as to how to amend conservation easements), with, e.g., Schwing, *supra* note 151 (arguing that it is wrong to promote amendment and termination of conservation easements).

181. See THOMAS E. ATKINSON, HANDBOOK OF THE LAW OF WILLS § 35 (2d ed. 1953) (stating that twelve jurisdictions had timing or size limitations on charitable bequests).

182. See MARK L. ASCHER, ELIAS CLARK, GRAYSON M.P. MCCOUCH & ARTHUR W. MURPHY, CASES AND MATERIALS ON GRATUITOUS TRANSFERS 224–26 (6th ed. 2013).

183. E.g., *Illinois ex rel. Madigan v. Telemarketing Assocs., Inc.*, 538 U.S. 600 (2003); *Riley v. Nat’l Fed’n of the Blind of N.C., Inc.*, 487 U.S. 781 (1988); *Sec’y of State of Md. v. Joseph H. Munson Co.*, 467 U.S. 947 (1984); *Vill. of Schaumburg v. Citizens for a Better Env’t*, 444 U.S. 620 (1980).

184. See *Nat’l Fed’n of the Blind v. FTC*, 420 F.3d 331, 334 (4th Cir. 2005); PRINCIPLES OF THE LAW OF NONPROFIT ORGS. § 620 cmt. b (Tentative Draft No. 3, 2011).

185. See PRINCIPLES OF THE LAW OF NONPROFIT ORGS. § 620 cmt. b (Tentative Draft No. 3, 2011).

186. E.g., UNIF. TRUST CODE § 816(13) (amended 2004); TEX. PROP. CODE ANN. § 113.025 (West 2013).

## VII. CONCLUSION

It is absurd to argue that a government that hands out tax exemptions and eligibility to receive tax-deductible contributions to entities that describe themselves as charities does not have the right or, indeed, a sacred responsibility to police the entitlements of the recipients of that largess. Thus, at least so long as we assume that charities *should* be tax-exempt and eligible to receive tax-deductible contributions, the federal government seems plainly entitled, if not obligated, both to identify the charities that initially qualify as such and to make certain that those that have already qualified behave in a manner consistent with the rationale for granting them these substantial benefits. Moreover, there is virtual consensus that the states have never been good at, or even truly interested in, policing charities and those who run them. Once the federal government got into the business of taxing income, gifts, and estates, and substantially subsidizing charity in the process, it basically had no option other than to assume primary responsibility for enforcing charity nationally.

That said, it is nigh impossible to argue that federalization of the law of charity has been an entirely good thing. First, the mind-numbingly complex patchwork of federal excise taxes leaves one wondering how things ever got so screwed up. If ever there were a topic that cried out for rationalization and serious simplification, this is surely it. Second, there is reason to believe that federalization of the law of charity does not *always* simply supplement state law, but that federal law sometimes strains, changes, and even crowds out state law. Third, federalization of the law of charity has undeniably increased the complexity and expense of organizing and operating charities and planning for the disposition of private wealth to or for the benefit of charitable undertakings.

Again, however, the point of this paper is much simpler: these days, just about the only charity-related law that really matters is federal.