

RHETORIC AND REALITY IN THE TAX LAW OF CHARITY

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INTRODUCTION

The rhetoric of public purposes in charity law has created the mistaken impression that charity is public and fulfills public goals, when the reality is that charity is private and cannot be expected to solve the problems that governments can solve. The rhetoric arises from a combination of charity-law history and tax expenditure analysis. The reality follows the money and control of charitable organizations.

Due to this mismatch, the tax law of charity endorses an entitlement to pre-tax income and a bias against taxation. Without the rhetoric, it would be clear that government wholly is responsible for public goods and distribution. Without the rhetoric, charities would be transparently private.

Public and private institutions should have distinct roles that derive from the identification of government responsibilities in a just society. Only government is in a position to guarantee equality and freedom, and the law should not create expectations that private charity will fulfill crucial public obligations. If government guarantees all the rights of citizenship, private organizations can focus on functions that government cannot serve. Charities have an important role in our heterogeneous society connected to fostering pluralism and diversity. They should not relieve the government of its more fundamental role in ensuring just institutions. On account of the rhetoric, tax benefits for charity have been subjected to too high a burden of justification. Private organizations that serve the public functions of challenging government, guaranteeing pluralism, and safeguarding private values deserve the benefits that charities currently receive under the law.

This Article contrasts the rhetoric of public benefit connected to charity in the law with the reality of private control of charitable organizations.¹ It argues that the tension between the rhetoric and reality have produced norms of entitlement that undermine taxation.² It offers an approach to the

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1. *See infra* Parts I, II.
2. *See infra* Part III.

role of charity under the law by defining the obligations of government in a just society, qualifying the economic framework dominant in the literature concerning charities, and identifying what private charity can achieve that governments cannot.³ This Article concludes by endorsing the charitable deduction in the tax law on terms consistent with this revised approach.⁴

I. THE RHETORIC OF THE TAX LAW DESCRIBES CHARITY AS PUBLIC

The rhetoric of the tax law treats charity as public by requiring public purposes for exempt organizations. This rhetoric is embedded in the history of charity law and perpetuated by tax expenditure analysis. It serves an important function today because it justifies tax benefits to exempt organizations and their donors, as well as the regulation of charitable organizations. That rhetoric comes from the earliest legal treatment of charitable institutions, continues through today in the language of tax expenditure analysis, and justifies the tax benefits and high expectations society has for charities.

A. Public Purpose Rhetoric Is Entrenched in the Legal Regime

The definition of charity in American law originates from England's Statute of Charitable Uses.⁵ Passed in 1601, the statute coincidentally produced a legal definition of charity.⁶ Its oft-quoted preamble lists its broad charitable purposes, which included both relief of the poor and support of a variety of public goods.⁷ English charitable trust cases were the main source of this early interpretation of charitable purpose.⁸ Justice Story recognized the Statute of Charitable Uses as the "principal source of the law of charities" in the United States, and the Court further developed the definition of charity in the charitable trust-law context.⁹ Over several cases, the Court defined charity as: (i) property for public use and (ii) lessening the burdens of the government.¹⁰ In 1879, the Court defined charity as "a gift for a public use."¹¹ In *Jackson v. Phillips*,¹² the Supreme

3. See *infra* Part IV.

4. See *infra* Part V.

5. See Lars G. Gustafsson, *Lessening the Burdens of Government: Formulating a Test for Uniformity and Rational Federal Income Tax Subsidies*, 45 U. KAN. L. REV. 787, 791 (1997).

6. See Lars G. Gustafsson, *The Definition of "Charitable" for Federal Income Tax Purposes: Defrocking the Old and Suggesting Some New Fundamental Assumptions*, 33 HOUS. L. REV. 587, 605 (1996).

7. See Charitable Uses Act 1601, 43 Eliz. 4 (Eng.).

8. See Gustafsson, *supra* note 5, at 795. A charitable gift was "[a] gift to a general public use, which extends to the poor as well as to the rich." *Jones v. Williams* [1767] Amb. 651, 652.

9. See Gustafsson, *supra* note 6, at 609 (citing Joseph Story, *On Charitable Bequests*, 17 U.S. (4 Wheat.) app. 5 (1819)).

10. *Perin v. Carey*, 65 U.S. 465, 506 (1860) ("All property held for public purposes is held as a charitable use, in the legal sense of the term charity.").

11. *Kain v. Gibboney*, 101 U.S. 362, 365 (1879).

12. 96 Mass. (1 Allen) 539 (1867).

Court of Massachusetts provided a definition of charity that encompassed the need for both the charitable class and the nature of the gift to be public. It stated that charity is “for the benefit of an indefinite number of persons . . . or . . . lessening the burdens of government.”¹³ That court later emphasized that “a gift for a purpose confined to that which is national in the sense that it might be supported at public expense and by general taxation is a close approach to a charity.”¹⁴

In the United States, the definition of charity for income tax purposes also was grounded originally in the Statute of Charitable Uses and subsequent charitable trust law that defined charity as serving public purposes.¹⁵ A 1939 House Report discussing the charitable exemption states that the exemption is “based upon the theory that the Government is compensated for the loss of revenue by its relief from financial burden which would otherwise have to be met by appropriations from public funds.”¹⁶ In *Bob Jones University v. United States*,¹⁷ the Court identified *Commission for Special Purposes of Taxation v. Pemsel*,¹⁸ as the “legal background against which Congress enacted the first charitable exemption statute in 1894.”¹⁹ The Court also characterized tax-exempt organizations as “entitled to tax benefits because they served desirable public purposes.”²⁰

The current definition of “charitable” as used in Internal Revenue Code (IRC) section 501(c)(3) follows this history of defining charity as providing public goods to relieve traditional government functions. In 1959, the Treasury adopted language that included “lessening the burdens of the government” as charitable in regulations under IRC section 501(c)(3).²¹ The current requirements for charitable exemption include an exempt purpose that requires an organization to “serve[] a public rather than a private interest.”²²

B. Tax Expenditure Analysis Fosters the Rhetoric

By constructing a framework in which charities appear to be the recipients of government funds by way of the charitable contribution deduction, tax expenditure analysis creates a strong impression that charity is public. Tax expenditure analysis instructs policymakers to analyze certain provisions in the tax law as though they were provisions of direct government spending, and the tax expenditure budget puts a dollar amount

13. *Id.* at 556 (emphasis added).

14. *Thorp v. Lund*, 116 N.E. 946, 949 (Mass. 1917).

15. *See Gustafsson, supra* note 6, at 623.

16. H.R. REP. NO. 1860, at 19 (1938).

17. 461 U.S. 574 (1983).

18. [1891] AC 531 (Eng.).

19. *Bob Jones*, 461 U.S. at 589.

20. *Id.*

21. The Statute of Charitable Uses language is part of 26 C.F.R. § 1.501(c)(3)-1(d)(2) (2014) (defining “charitable”).

22. *Id.* § 1.501(c)(3)-1(d)(1)(ii).

on the revenue loss from the charitable contribution deduction.²³ From a budgetary perspective, a tax expenditure is a substitute for an appropriated expenditure—the government can reduce taxes for some people on account of participation in certain activities, or it can directly appropriate funds for those activities. Tax expenditures have been analyzed as the equivalent of federal matching grants to emphasize the government subsidy they provide.²⁴ The implication of the existence of a tax expenditure *budget* is that the government could raise the foregone revenue if Congress repealed the identified provision.²⁵ Government must be subsidizing charities if the budget shows it in black and white—and the subsidy looks large!

The Treasury Department's budget separates the charitable deduction into three categories by function, so that no aggregate charitable revenue loss appears in the budget.²⁶ The latest budget includes three categories for 2015 to 2024: \$69.4 billion for contributions to education, \$68.5 billion for contributions to health, and (a whopping) \$606.75 billion for the deductibility of other contributions.²⁷ The "other" category is the tenth largest tax expenditure in the entire budget, and, if all three categories were aggregated, the tax expenditure for the charitable deduction would be the eighth largest overall.²⁸ A \$745 billion ten-year revenue loss in the federal budget²⁹ suggests that the government is invested heavily in the charitable sector.

More subtly, tax expenditure analysis creates a construct for treating donations as partly funded by the government because charities are not taxpayers. Tax expenditure analysis directs its policy evaluation gaze at the taxpayer who claims a deduction. Thus, when a policymaker sees that a tax expenditure is \$X, she analyzes it as she would any appropriation in that amount. This way of thinking about tax expenditures, namely as equivalent to direct spending equal to the revenue loss, led Stanley Surrey to suggest that the government pays for 70 percent of the mortgage interest of high-

23. See OFFICE OF MGMT. AND BUDGET, ANALYTICAL PERSPECTIVES (2016), https://www.whitehouse.gov/sites/default/files/omb/budget/fy2017/assets/ap_14_expenditures.pdf [https://perma.cc/F4G8-QVUM]. See also generally JOINT COMMITTEE ON TAXATION, <https://www.jct.gov/publications.html?func=select&id=5> (last visited Apr. 29, 2016) [https://perma.cc/NW7V-JN7F].

24. See, e.g., Paul R. McDaniel, *Federal Matching Grants for Charitable Contributions: A Substitute for the Income Tax Deduction*, 27 TAX L. REV. 377 (1972).

25. The calculation is not so simple because repeal of the provision would lead to other changes in the economy. See John L. Buckley, *Tax Expenditure Reform: Some Common Misconceptions*, 132 TAX NOTES 255, 259 (2011).

26. The tax exemption is not treated as a tax expenditure. This may be due to the difficulty of determining the normal amount of tax a charity should pay. See generally Boris I. Bittker & George K. Rahdert, *The Exemption of Nonprofit Organizations from Federal Income Taxation*, 85 YALE L.J. 299 (1976).

27. OFFICE OF MGMT. AND BUDGET, FISCAL YEAR 2016 ANALYTICAL PERSPECTIVES OF THE U.S. GOVERNMENT 240 tbl.14-3 (2015) <https://www.whitehouse.gov/sites/default/files/omb/budget/fy2016/assets/spec.pdf> [https://perma.cc/36CA-F4P9].

28. And almost as large as the revenue loss arising from the step-up basis of capital gains at death. See *id.*

29. Tax expenditures have a separate section, but are part of the Office of Management and Budget's presentation of the total federal budget. See *id.*

income taxpayers (whose marginal income tax rate was 70 percent), but none of the mortgage interest of low-income taxpayers (who paid no tax).³⁰ Surrey believed that a tax expenditure that allows a homeowner to save \$100 in taxes is equivalent to a \$100 check from the government to that homeowner. A reduction in taxes is a real economic benefit.

The analysis for tax expenditures involving charities is slightly more complex because the tax reduction occurs for the donor, but the policy behind the deduction assumes that the donor does not receive the economic benefit of it. The assumption underlying the deduction for contributions to charities is that donors gross up their contributions so that the tax savings they enjoy is passed along to the charity. The deduction is an incentive for donors to increase their contributions, so the incidence of the tax benefit is on the charities.³¹ If taxpayers simply enjoyed reduced tax liabilities on account of the deduction, the charitable deduction would benefit donors by providing them with a bonus for giving. It would not benefit charities, which Congress presumably meant to subsidize with the provision—and it would be a very odd provision from a policy perspective.³² If donors captured the tax benefits for themselves, people would understand the tax provision to reduce donor tax, like the homeowner in Surrey’s example.³³ Reducing a donor’s tax is an economic benefit, but it has subtly different implications than a direct public subsidy.³⁴

Where a charity receives the benefit of an increased donation on account of a tax deduction, it is tempting to argue that there is *real* public funding because the charity is not a taxpayer. The subsidy cannot be conceptualized as a tax reduction where the beneficiary has no tax to pay. In this way, charities are unlike individuals with home mortgages and similar to individual recipients of refundable credits. The public sees a much clearer transfer of dollars from the government to the charitable organizations (and the poor recipients of the Earned Income Tax Credit (EITC)) where the recipient of the tax benefit is not otherwise a taxpayer. Although it includes the outlay portion in its estimates in its tax expenditure budget, the Joint Committee on Taxation includes a footnote separating the refundable

30. STANLEY S. SURREY, *PATHWAYS TO TAX REFORM* 36–37 (1973) (“One can assume that no HUD Secretary would ever have presented to Congress a direct housing program with this upside-down effect.”).

31. There is some conflicting data on whether the deduction is in fact an incentive. See Gerald E. Auten, Holger Sieg & Charles T. Clotfelter, *Charitable Giving, Income, and Taxes: An Analysis of Panel Data*, 92 AM. ECON. REV. 371 (2002); Jon Bakija & Bradley T. Heim, *How Does Charitable Giving Respond to Incentives and Income? New Estimates from Panel Data*, 64 NAT’L TAX J. 615 (2011); William C. Randolph, *Dynamic Income, Progressive Taxes, and the Timing of Charitable Contributions*, 103 J. POL. ECON. 709 (1995).

32. We need to better understand whether donors are being subsidized this way. See Linda Sugin, *Tax Expenditures, Reform, and Distributive Justice*, 3 COLUM. J. TAX L. 1, 23–25 (2011).

33. See *infra* Part III.C.

34. Recipients of tax benefits like the home mortgage deduction do not see themselves as recipients of government subsidy. See Bryce Covert, *We All Get ‘Free Stuff’ from the Government*, N.Y. TIMES (Oct. 8, 2015), <http://www.nytimes.com/2015/10/08/opinion/we-all-get-free-stuff-from-the-government.html> [https://perma.cc/Z598-4P4P].

portion of the EITC from the nonrefundable part.³⁵ That presentation suggests that there is something fundamentally different about the refundable portion and the nonrefundable portion of the credits. The “outlay” label applied to the refundable part implies a greater level of government involvement than letting individuals reduce their taxes.

C. Consequences of Public-Purpose Rhetoric

The rhetoric of public purposes throughout the law of charity is essential to the structure of the federal tax law of charity. It justifies the tax benefits for charitable organizations and their donors. The classic justification for charitable tax benefits is based on a subsidy theory premised on the goods provided by charities to the public.³⁶ The exemption and deduction are good policy because they serve to subsidize the goods that charitable organizations produce. “Charities generate primary public benefits either by providing goods or services that are deemed to be inherently good for the public, or by delivering ordinary goods or services to those who are recognized as being especially needy.”³⁷

The public-purpose rhetoric and the tax benefits that depend on it form the basis for the federal regulation of nonprofits that we have. The federal tax law is the single most significant regulatory structure governing nonprofit organizations.³⁸ But Congress never set out directly to regulate the governance or activities of nonprofits (as it has with for-profit organizations in the securities acts). Instead, the regulation of nonprofits hangs on the tax benefits granted to them.

The entire legal-regulatory structure depends on recognizing a jurisdictional hook in the charitable exemption and deduction. That is a heavy justification for a fine thread.³⁹ The leading authority justifying this regulation is the Supreme Court’s decision in *Regan v. Taxation with Representation of Washington*.⁴⁰ There, the Court upheld the IRC’s restriction on the political activities of charities by describing the tax exemption and charitable deduction as privileges that Congress can choose

35. JOINT COMM. ON TAXATION, ESTIMATES OF FEDERAL TAX EXPENDITURES FOR FISCAL YEARS 2014–2018, tbl.1, 34 n.4 (2014).

36. See John Simon, Harvey Dale & Laura Chisolm, *The Federal Tax Treatment of Charitable Organizations*, in THE NONPROFIT SECTOR: A RESEARCH HANDBOOK 267, 274 (Walter W. Powell & Richard Steinberg eds., 2d ed. 2006) (“[The] most traditional of the normative arguments . . . holds that exemption and deductibility are needed to promote the provision of certain kinds of benefits to the public.”).

37. Rob Atkinson, *Theories of the Federal Income Tax Exemption for Charities: Thesis, Antithesis, and Syntheses*, 27 STETSON L. REV. 395, 402 (1997).

38. See generally James J. Fishman, Commentary, *The Federalization of Nonprofit Regulation and Its Discontents*, 99 KY. L.J. 799 (2011).

39. See Marcus S. Owens, *Charity Oversight: An Alternative Approach* 2, 8 (The Hauser Ctr. for Nonprofit Orgs. at Harvard Univ., Working Paper No. 33.4, 2006) (arguing that the IRS is structurally ill-suited to its charitable regulatory function, in part because it is constrained by the terms of the tax law authorizing oversight).

40. 461 U.S. 540 (1983).

to limit.⁴¹ The constraint on an organization's First Amendment rights imposed by the lobbying/campaigning restrictions in section 501(c)(3) was considered acceptable because the Court treated the restriction as attaching only to a government subsidy and not to an organization's rights to speak more broadly.⁴² This reasoning has elevated the importance of the public subsidy in the legal framework, even though that subsidy makes up a small portion of the total resources in the nonprofit sector.⁴³

By focusing on public subsidy, the rhetoric surrounding the exemption and the charitable deduction creates an impression that the government is attentive to, and invested in, charitable organizations. Regardless of the reality, that focus in turn validates the requirement of public purposes: if government spends revenue on charitable organizations, it must be because those organizations carry out important public functions. Despite its facial normative neutrality, tax expenditure analysis creates an expectation that charities will deserve their public largesse by satisfying public purposes.

Despite the influence of tax expenditure analysis, the public subsidy of organizations through the deduction is more ambiguous than generally acknowledged. The incidence of the deduction determines whether donors are rewarded or charities are subsidized. The deduction subsidizes charities only if it effectively incentivizes donors to increase their donation by at least as much as the tax savings. If they fail to increase their giving, then the deduction operates as a windfall to donors, who are rewarded for giving to charity.⁴⁴ Consequently, the charitable contribution deduction is as much about donors as it is about charities. A single-minded focus on subsidies to charities misses a crucial part of the story.

II. THE REALITY OF THE TAX LAW MAKES CHARITY PRIVATE

The last part explained the sources and consequences of the rhetoric that characterizes the tax law of charity as public. This part examines the legal, economic, and governance structure of charitable organizations to challenge that characterization; it argues that charity is fundamentally private. The next part, Part III, explains why the mismatch of rhetoric and reality undermines fairness in taxation.

41. Both tax exemptions and tax deductibility are forms of subsidies that are administered through the tax system. *Id.* at 544.

42. *Id.* at 546 (“Congress has simply chosen not to pay for TWR’s lobbying.”).

43. The relative dollar value of tax benefits compared to other sources of funds for the charitable sector is difficult to determine because it is not clear what tax would otherwise be paid. If all funds available to all charities came from tax-deductible donations, the public subsidy still would be significantly less than half of all resources available. Since the charitable sector collects more in fees for services than it does in contributions, the public subsidy piece is necessarily much smaller. See *Quick Facts About Nonprofits*, NAT’L CTR. CHARITABLE STATS.: URB. INST., <http://nces.urban.org/statistics/quickfacts.cfm> (last visited Apr. 29, 2016) [<https://perma.cc/4L6Q-MSWG>].

44. For a more developed analysis of the distinction between a subsidy and an incentive and why it matters for charitable contributions, see Sugin, *supra* note 32, at 23–26.

A. Choice Is Private

The entire tax law of charity is built on a regime of choice, rather than obligation. Nobody is forced to support public goods where the government operates solely through a tax deduction. Because the tax law places that choice to fund in the hands of taxpayers, the charitable deduction creates an inference that the funding of public goods and distribution is a matter of private choice, rather than public responsibility. Under current law, government does not direct the overall level of funding. The level of support of any charitable good depends on the preferences and resources of individuals in a position to donate funds. In this way, the tax law of charity makes the government less important and less responsible.

Everything about the substance of the tax law defines charity as fundamentally private. The tax law contemplates private creation, private governance, and private funding of exempt organizations. The charitable sector is minimally regulated. The tax exemption is in the nature of an entitlement for organizations that can fit within its broad terms. Any organization can limit its activities in a way that satisfies the statutory requirements and creates an entitlement so that government has no direct control over which organizations will be eligible for the subsidy. Charitable organizations must apply for recognition of exemption, but the government does not determine the number of organizations, their total funding levels, or their functions. While organizations must satisfy the regulation's imperative to "serve[] a public rather than a private interest,"⁴⁵ the tax law contains no system for evaluating how well a public interest is served—an organization's effectiveness in carrying out a public purpose is not subject to review. The tax law's enforcement capability is limited to monitoring prohibitions, not demanding results.⁴⁶

Evelyn Brody and John Tyler have surveyed the essential privateness of charitable organizations in an attempt to refute arguments for greater regulation of the nonprofit sector.⁴⁷ They distinguish the implications that follow from the requirement that charities have public purposes from the claim that charities are financed with public money. In the course of their analysis, they observe that private philanthropy is hardly public at all and conclude that the law recognizes "the importance of philanthropic independence, respect[s] philanthropies as private entities, and accord[s] them the right to autonomy without undue government or public direction and control."⁴⁸

45. 26 C.F.R. § 1.501(c)(3)-1(d)(1)(ii) (2014).

46. The government will move to revoke an exemption if an organization engages in politics, *see* *Christian Echoes Nat'l Ministry, Inc. v. United States*, 470 F.2d 849 (10th Cir. 1972), or engages in racial discrimination, *see* *Bob Jones Univ. v. United States*, 461 U.S. 574 (1983).

47. EVELYN BRODY & JOHN TYLER, *HOW PUBLIC IS PRIVATE PHILANTHROPY? SEPARATING REALITY FROM MYTH* (1st ed. 2009).

48. *Id.* at 11.

B. A Tax Deduction Is Weak

The charitable contribution deduction represents a weak financial commitment to charity because it contains no unconditional commitment to public support at all. It is weak because the charitable contribution deduction is only a percentage of private support, up to a maximum equal to the highest marginal rate of tax. It is weak because the statutory definition for a charitable organization is broad and vague and requires substantial private determination for its contours. The charitable contribution deduction is reactive, responding to the private choices that individuals make, requiring that the government follow the lead of private individuals and never empowering it to choose priorities.

The choice of a tax deduction indicates that Congress did not intend to exert much control over charitable organizations, since a deduction-based subsidy fosters the private control of charitable organizations. The tax law is only one of a variety of mechanisms that the government uses to subsidize institutions. Compared to other mechanisms, the charitable deduction delegates much greater decision-making power away from the government to private individuals. Donors decide how much to fund charities and which charities will be funded. Self-perpetuating boards of directors decide which projects to pursue and how much to spend on them. The charitable deduction demands no accountability from any charity to the government as a condition of any particular gift.

Compared to other mechanisms that the government regularly uses, tax-based financing is contingent, stingy, and unpredictable. For instance, the tax law of charity is in sharp contrast to the rules of public contracts. Under contracting rules, governments fund, direct, and evaluate the activities of private organizations (sometimes charities, but not necessarily). Private organizations carry out specific functions that the government chooses and that remain the government's responsibility. Unlike government contractors, charitable organizations retain complete autonomy when they are the recipients of tax-based support.

C. Tax Deductions Allow Individuals to Keep Their Money

As described in Part I, tax expenditure analysis challenges the policymaker to consider tax expenditures as direct spending programs primarily for the purpose of drawing attention to their distributional effects. Surrey's home mortgage interest deduction example makes that policy purpose plain.⁴⁹ At most, tax expenditure analysis equates tax expenditures with direct spending from the government's budgeting perspective, but it does not create a compelling parallel framework for individuals.⁵⁰ A tax deduction does not necessarily imply that a homeowner is funded by the government. Instead, a homeowner receives a reduction in tax liability and is allowed to keep more of his pre-tax income. This is an example of how

49. See *supra* note 30 and accompanying text.

50. See Covert, *supra* note 34.

tax expenditure analysis may be a useful budgeting tool, but is an imperfect legal archetype⁵¹ and an incomplete substitute for other perspectives.

As a legal matter, the Supreme Court also refuses to equate tax expenditures with government support from the taxpayer's perspective. The judicial characterization of the charitable deduction emphasizes the private nature of charitable contributions because it conceptualizes tax expenditures as tax cuts that allow individuals to spend their own money (and not the government's).⁵² In *Arizona Christian School Tuition Organization v. Winn*,⁵³ the Court's latest analysis of tax expenditures, the Supreme Court "transformed tax expenditures from state action, ordinarily subject to constitutional limits, into nonreviewable private spending by individuals."⁵⁴ The Court characterized tax expenditures as decisions by the legislature to *not tax*, rather than as decisions to subsidize.⁵⁵ This characterization rejects tax expenditure analysis as a legal framework and undermines the public subsidy equivalence. Tax expenditure analysis' central observation that tax deductions and direct government spending are economically equivalent is legally irrelevant.

At the same time, the Court's legal characterization (over)emphasizes the private nature of charitable giving by ignoring economic effects altogether. In the facts before the Supreme Court, the tax expenditure at issue was a 100 percent credit for donations to certain educational organizations.⁵⁶ In a 100 percent credit, the taxpayer saves one dollar for every dollar in contribution, so the public subsidy analysis would have been most compelling. By treating the payments as purely private, the Court ignored both the central policymaking function of the state legislature in adopting the tax credit and the revenue effects of a credit that reduces tax by a full dollar for every dollar spent in a statutorily favored way.

III. PRIVATE CHARITY REFLECTS A BIAS AGAINST TAXATION

The Supreme Court's approach in *Arizona Christian School* supports a taxpayer's right to pre-tax income. The Court's rejection of the economic equivalence emphasized by tax expenditure analysis implies that taxpayers have complete ownership of their pre-tax income, regardless of the underlying tax structure that allows individuals to retain more or less of that income. The law also creates an entitlement to pre-tax income by allowing individuals a choice about supporting public goods and distribution and by then granting tax deductions if they do. This bias in the tax law of charity is consistent with the tax law's overall tendency to elevate private property

51. See Linda Sugin, *Tax Expenditure Analysis and Constitutional Decisions*, 50 HASTINGS L.J. 407, 415–18 (1999).

52. See *Ariz. Christian Sch. Tuition Org. v. Winn*, 131 S. Ct. 1436, 1447 (2011) (noting that "the government declines to impose a tax" when it allows a credit).

53. 131 S. Ct. 1436 (2011).

54. Linda Sugin, *The Great and Mighty Tax Law: How the Roberts Court Has Reduced Constitutional Scrutiny of Taxes and Tax Expenditures*, 78 BROOK. L. REV. 777, 778 (2013).

55. See *Ariz. Christian Sch. Tuition Org.*, 131 S. Ct. at 1447.

56. See ARIZ. REV. STAT. ANN. § 43-1089 (2010).

and is the product of a particularly narrow conception of taxation. This part explains why the inconsistent rhetoric and reality of charities in the tax law normalizes a particular conception of entitlement and undermines tax fairness.

A. *Two Models of Taxation*

There are two ways to conceptualize the function of taxation. One approach treats taxation as fundamental to determining individual shares of social product, and the other approach treats taxation as appropriation of private property. A fair shares framework sees the tax system as a mechanism for dividing the returns to social cooperation among members of society.⁵⁷ In a fair shares approach, individuals are not entitled to their entire pre-tax income because part of that income is the return to social cooperation that must be shared with others. Distribution is the job of government under that approach—there is no *redistribution* because the returns to social cooperation are distributed before any claims are made on them. Under the fair shares conception, pre-tax income is an arbitrary number that is normatively meaningless. That approach treats taxation as an effective mechanism to distribute the returns to social cooperation across society. So, while you may hold your pre-tax income, you are not entitled to own it.

The opposite is true under the appropriation conception. Where private property ownership is the baseline, taxation must satisfy a burden to prove that government appropriation is justified.⁵⁸ This approach assumes that morally, individuals are entitled to their pre-tax income and that society has no presumptive right to any part of it, despite its essential role in the creation of all income. Pre-tax income assumes central moral significance, and taxation can resemble slavery, as Robert Nozick dramatically claimed.⁵⁹ The fair shares approach reflects a more expansive role for government and a correspondingly lower level of private prerogative than does the appropriation conception. The tax law of charity is consistent with the appropriation model since it emphasizes choice and reinforces entitlement. A more expansive understanding of public responsibility—with taxation to finance it—would leave fewer resources in private hands for private decision making.⁶⁰

B. *Charity Law Supports an Entitlement to Pre-Tax Income*

Incentives for individual generosity make sense in a private entitlement conception of taxation. The tax law of charity contributes to that

57. See Linda Sugin, *Don't Give Up on Taxes*, 145 TAX NOTES 1374 (2014) (“The most fundamental tax fairness question asks what should be treated as private property and what should be treated as social product.”).

58. See LIAM MURPHY & THOMAS NAGEL, *THE MYTH OF OWNERSHIP: TAXES AND JUSTICE* (2002) (coining the term “everyday libertarianism” to describe this phenomenon).

59. ROBERT NOZICK, *ANARCHY, STATE AND UTOPIA* 169 (1974) (describing taxation as “forced labor”).

60. See *infra* Part IV.

conception by nudging individuals to choose altruism and thereby fund public goods and distribution. The charitable deduction treats donors as taking from their private store of wealth to provide for the social good, reinforcing a private entitlement to pre-tax income. Alternatively, the charitable deduction can be seen as a pure reward to donors for their public spiritedness, because there is no requirement that the deduction actually inure to the benefit of charities, as the term “incentive” implies.⁶¹

The charitable deduction gives taxpayers a reason to believe that they are morally entitled to their pre-tax income because the tax law makes a mere request that individuals give and then compensates those who do by reducing their tax bill. The tax law incentivizes contributions—signaling that a reasonable and rational member of society might legitimately choose not to pay for the public goods and redistribution that charities provide. If we need to sweeten the deal for people to make them fund public goods and redistribution, then we create a normative context in which it is acceptable not to fund those things. The characterization of donors as supporters of public purposes equates their contributions to charity with their tax payments to government, justifying lower taxation for the wealthy and a smaller public sector overall. If the rich are already financing public goods and distribution privately, there is little need for the public sector to tax them and duplicate their efforts.

Treating private philanthropy as a reasonable substitute for taxation mitigates the importance of the mandatory nature of taxation. Individually directed giving becomes equivalent to publicly determined obligations. “Relieving the burdens of government” rhetoric gives a tax-like character to funds spent on private philanthropy. Private giving is in lieu of—and equivalent to—the payment of taxes.⁶² The rhetoric suggests that taxation is similar and comes from the same place as philanthropy—an individual’s separately owned funds. Consequently, the rhetoric fosters a strong entitlement to pre-tax income.

Charity law promotes the private property interests of donors by giving donors more protection under the law of charity than anyone else. The most generous tax benefits are only available for donors⁶³—and are sometimes outrageously generous, such as the deduction equal to the fair market value of appreciated property. If marginal tax rates exceed 50 percent (as they have in the past), donors are paid a bonus by the government to give their appreciated assets to charity.⁶⁴ Donors are entitled to deductions for their gifts, even if they donate to a foundation or fund that

61. See *supra* note 32 and accompanying text.

62. See Simon, Dale & Chisolm, *supra* note 36, at 275.

63. The deduction is more valuable than the exemption. See Evelyn Brody, *The Legal Framework for Nonprofit Organizations*, in *THE NONPROFIT SECTOR: A RESEARCH HANDBOOK*, *supra* note 36, at 243.

64. Assume an asset is worth \$100 and *T* has a zero basis. If *T* has a marginal rate of 70 percent, sale of the asset would produce \$70 tax, leaving \$30 for *T* to spend after tax. If *T* instead donates it to charity, he is better off because he will enjoy a \$100 tax deduction and pay no tax on the appreciation. The deduction saves him \$70 in tax, \$40 more than he enjoys if he sells the property.

they continue to control and even if the money cannot be used by any charity for years. The tax law requires that charities disclose their financial information publicly⁶⁵—that disclosure enables donors to decide whether *their* money is well managed, even after it is irrevocably in the charity's coffers. The central feature of nonprofit law is the nondistribution constraint, which primarily protects donors because it ensures that charity managers use donations for the purpose of the organization, rather than for themselves.⁶⁶ It is a feature of both federal tax law⁶⁷ and state nonprofits law.⁶⁸ Under state law, protection of donors is central. Courts enforce donor's gift restrictions, even if the restrictions are obsolete and the donor is long dead.⁶⁹ States exert substantial efforts to combat fraud in charitable solicitations,⁷⁰ which primarily protect the expectations of donors. These elements of state nonprofits law contribute to a private conception of charity and treat donors as equivalent to owners.

Due to the provisions of both federal and state law, donors continue to exert substantial power under state charities law long after their donation is complete. And the law is largely designed to protect their interests. To the contrary, tax revenue comes under the unfettered control of government immediately, and taxpayers have no rights to direct the use of their payments.⁷¹

65. 26 U.S.C. § 6104 (2012).

66. Henry Hansmann's theory explaining nonprofit organization is explicit in describing how the regime protects donors. See Henry Hansmann, *The Role of Nonprofit Enterprise*, 89 YALE L.J. 835, 862 (1980) (explaining that nonprofits exist to give confidence to donors).

67. This is the prohibition on inurement in 26 U.S.C. § 501(c)(3).

68. This is the case in every state. See generally MARION R. FREMONT-SMITH, GOVERNING NONPROFIT ORGANIZATIONS: FEDERAL AND STATE LAW AND REGULATION (2004).

69. Any request to modify the use of funds must be judicially determined in a "cy pres" proceeding. Courts apply a high standard in allowing charities to modify their promises. See generally Rob Atkinson, *Reforming Cy Pres Reform*, 44 HASTINGS L.J. 1111 (1993) (explaining the policy behind cy pres and reviewing arguments in the literature). In a recent case, Paul Smith College was not permitted to change its name, even though the named donor is long dead. See *In re Paul Smith's Coll. of Arts & Scis.*, No. 2015-0597 (N.Y. Sup. Ct. Oct. 6, 2015), <https://www.scribd.com/doc/283978772/Paul-Smith-s-College-decision> [<https://perma.cc/Ry6H-AURR>]. Similarly, the Buck Trust has to spend millions each year in Marin County—even though Marin does not quite know what to do with the money. *In re Estate of Buck*, No. 23259 (Cal. Super. Ct. Aug 15, 1986), reprinted in 21 U.S.F. L. REV. 691 (1987).

70. States adopted statutes, which the Court struck down under the First Amendment three times, holding that the laws placed various restrictions on charitable solicitations that were not sufficiently related to the state's interest in preventing fraud. See *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). Nevertheless, the states continue to persevere in this area by bringing post-hoc individualized fraud actions rather than legislating rules for allowable solicitations, see *Madigan v. Telemarketing Assocs. Inc.*, 538 U.S. 600 (2003), and by publicizing fundraising abuses, see e.g., *Pennies for Charities: Where Your Money Goes*, N.Y. ST. OFF. ATT'Y GEN., <http://charitiesnys.com/pfcmap/index.jsp> (last visited Apr. 29, 2016) [<https://perma.cc/X22D-HJAV>].

71. There is no general taxpayer standing. See *Ariz. Christian Sch. Tuition Org. v. Winn*, 131 S. Ct. 1436, 1442 (2011) ("[S]tanding cannot be based on a plaintiff's mere status as a taxpayer.").

C. *The Mismatch of Rhetoric and Reality Is a Problem*

It is not a problem that charity is private. It is a problem that charity is private *and* coated with a public rhetoric. That combination creates a bias against taxation that contracts the scope of government. The mismatch offers justification for allocating responsibility for public purposes to private organizations. It creates an appearance of enabling private organizations to engage in distribution, without actually requiring them to do so. The U.S. tax system has the most generous tax subsidies for charity and the most robust private charitable sector in the world.⁷² These facts make it tempting to excuse government from its responsibility for providing public goods and distribution, even where private organizations cannot achieve goals on the scale of government.

The public-purposes rhetoric surrounding charities creates the impression that private organizations are the appropriate solution to a wide range of public challenges. We are accustomed to private organizations taking responsibility for the most standard kinds of public goods like elementary schools⁷³ and public parks.⁷⁴ The existence of a dynamic and well-funded charitable sector may obscure the need for public institutions to take responsibility for public goods and distribution.

The critique widely made about charities reflects the hazard of the public rhetoric. Charities are often (accurately) critiqued for exclusivity—they certainly can be exclusive when they are supported by the rich and perform functions that are specialized.⁷⁵ But exclusivity is only damning if we accept that the function of charity is to be inclusive. We only believe that charities should be inclusive because the rhetoric describes them as public, even though they are not. Those who object to charities that do too little to help the poor assume that the proper role of charity is to help the poor.⁷⁶ But if that is not the objective, it is odd to judge them on those terms.

Anyone who turns to charity for distribution cannot really be committed to distributive justice because the law of charity—which is fundamentally

72. See HUDSON INST., THE INDEX OF PHILANTHROPIC FREEDOM (2015), <https://s3.amazonaws.com/media.hudson.org/files/publications/2015.06.15IndexofPhilanthroIndexofPhi2015.pdf> [<https://perma.cc/K6DR-ZPKV>].

73. Charter schools are privately run, but heavily regulated. They receive both public and private funding.

74. The Parks Conservancy is responsible for New York City's Central Park. See *About the Conservancy*, CENT. PARK CONSERVANCY, <http://www.centralparknyc.org/about/about-cpc/> (last visited Apr. 29, 2016) [<https://perma.cc/F3SR-B8FU>].

75. See Teresa Odendahl, *Charity Begins at Home: Generosity and Self-Interest Among the Philanthropic Elite*, reprinted in NONPROFIT ORGANIZATIONS: CASES & MATERIALS 817 (James J. Fishman & Stephen Schwartz eds., 4th ed. 2010); see also Peter Singer, *Good Charity, Bad Charity*, N.Y. TIMES (Aug. 10, 2013), http://www.nytimes.com/2013/08/11/opinion/sunday/good-charity-bad-charity.html?_r=0 [<https://perma.cc/3GNK-8GVC>]. Singer's arguments are purely welfarist. He argues that "we will achieve more if we help those in extreme poverty in developing countries, as our dollars go much further there." *Id.*

76. John Colombo reviews the literature in *The Role of Redistribution to the Poor in Federal Tax Exemption for Charities*, 21 N.Y.U. NAT'L CTR. ON PHILANTHROPY & L. CONF. § B (2009), <http://www1.law.nyu.edu/ncpl/resources/documents/Conf2009JColomboPaper.pdf> [<https://perma.cc/4BYN-AZ4E>].

private—is not designed to make charities effective in distributing. Inability to effectively redistribute is simply a feature of charity design because it is privately funded and privately controlled. Distributive justice requires centralized power and control—precisely what is purposely lacking in the charitable sector.⁷⁷ A real commitment to distributive justice is only feasible for governments because only governments have sufficient scope and power.

IV. REDEFINING THE PROJECT OF DEFINING PUBLIC AND PRIVATE

This part outlines what a real commitment to distributive justice might demand of both government and the charitable sector. It emphasizes the basic responsibilities of government in a just society, critiques the conventional efficiency-based explanation for charitable institutions, and concludes with a limited institutional approach to the charitable sector.

A. Start with a Normative Theory of Government Responsibility

Based on a theory of good government, we need to better consider the proper allocation of private and government functions. It is odd that we often start thinking about the legal regime for charities by asking what charities should do and how the law should treat them. The justice of the tax treatment of charity cannot be determined in isolation. Instead, the proper tax treatment of charity depends on the overall operation of the institutional structure of government.⁷⁸ We cannot ask whether the tax provisions for charity are just, without also asking about all the other institutions of government involved in providing public goods and distribution. An inadequate regime of government protection cannot be remedied by a generous private law of charity. In a just society, charitable institutions would not *need* to provide public goods or distribution.

In defining the tax treatment of charities, we need to better distinguish them from government. In doing so, we can reinforce the obligation of government to provide public goods and redistribution. If we justify the subsidy to charity because it does the things that government is best suited to do, then we obscure the real social benefit of charity, which consists of doing things better than, or different from, what the government can do. The existence of charity should not serve as an excuse for government to fall short in its responsibility to provide public goods and distribution. The task for thinking about the role of charitable organizations depends on what needs to be private.

77. This is precisely why Robert Nozick rejects the notion of distributive justice, he says: “There is no central distribution, no person or group entitled to control all the resources, jointly deciding how they are to be doled out.” NOZICK, *supra* note 59, at 149.

78. This is a Rawlsian approach. *See generally* JOHN RAWLS, *A THEORY OF JUSTICE* (rev. ed. 1999) (justice is a matter of basic institutions).

The normative underpinning for the traditional subsidy theory for the tax exemption and charitable deduction for charities—provision of public goods and redistribution⁷⁹—is also the explanation for taxation and public provision of services that are shared, scalable, or otherwise commonly enjoyed, such as clean water and national defense. This precise overlap is problematic because it fails to give a unique justification for the charitable sector and fails to define the appropriate space for government compared to private organizations. The public goods and distribution explanations are better explanations for government provision than they are for charitable provision, because economic theory predicts that private choices will lead to an underprovision of public goods and redistribution.⁸⁰

B. Economic Theories Are Helpful, but Inadequate

If we start by asking about government—what it should do—we are in a better position to demand a normative explanation for the division of the public and private sectors. Much of the literature on the law of the charitable sector is economic. Even legal scholars often turn to economic theories when thinking about charity law. For example, Mark Hall and John Colombo's donative theory explaining the exemption is an elaboration on Henry Hansmann's economic analysis.⁸¹ Nina Crimm's risk compensation theory of the exemption is also economic.⁸² So is Mark Gergen's theory of the charitable deduction.⁸³ Rob Atkinson has valiantly attempted to design a theory not based on economic analysis, and he continues to develop a philosophical approach.⁸⁴ His instinct must be correct: the division between sectors is a question of political morality, so we need a political theory that divides the public from the private.

One of the leading economic theories explaining the separation of government functions and private nonprofit functions is Burton Weisbrod's theory of government failure and the median voter.⁸⁵ Weisbrod observes that the government must satisfy the median voter, and, consequently, there are many projects that the government cannot do.⁸⁶ The theory presumes

79. See Simon, Dale & Chisolm, *supra* note 36, at 274.

80. See Burton A. Weisbrod, *Toward a Theory of the Voluntary Non-Profit Sector in a Three-Sector Economy*, in *THE VOLUNTARY NONPROFIT SECTOR* 51 (Burton A. Weisbrod ed., 1977).

81. See generally JOHN D. COLOMBO & MARK A. HALL, *THE CHARITABLE TAX EXEMPTION* (1995).

82. See generally Nina J. Crimm, *An Explanation of the Federal Income Tax Exemption for Charitable Organizations: A Theory of Risk Compensation*, 50 *FLA. L. REV.* 419 (1998).

83. See generally Mark P. Gergen, *The Case for a Charitable Contributions Deduction*, 74 *VA. L. REV.* 1393 (1988).

84. See Rob Atkinson, *Philanthropy's Function: A Neo-Classical Re-Consideration*, in *NOT FOR PROFIT LAW: THEORETICAL AND COMPARATIVE PERSPECTIVES* 15 (Matthew Harding et al. eds., 2014); Rob Atkinson, *Altruism in Nonprofit Organizations*, 31 *B.C. L. REV.* 501 (1990) [hereinafter Atkinson, *Altruism in Nonprofit Organizations*]; Rob Atkinson, *Tax Favors for Philanthropy: Should Our Republic Underwrite De Tocqueville's Democracy?* 6 *WM. & MARY POL'Y REV.* 1 (2014).

85. Weisbrod, *supra* note 80, at 53.

86. See *id.* at 59–61.

that nonprofits will step in to fill the void where the political process prevents the government from acting.

While the median voter theory may be a compelling explanation of the allocation of functions observed on the ground, it is only sometimes normatively attractive. The median voter theory is informative as a positive matter—there are public goods that the median voter, for whatever reason, fails to value enough to demand that government provide them. But that theory is not a normative theory of good government, and the question of how governments and private organizations should allocate responsibilities is a normative question. If the median voter is selfish, it is still the obligation of government, and not private organizations, to guarantee the basic rights and freedoms of individuals in society.

Where political posturing and ideological gridlock prevent the government from acting, government failure should be remedied directly. Irresponsible politics should not be a justification for allowing government to shirk fundamentally public responsibilities. The limitations on government that arise from the majoritarian political process can be understood as falling in two categories: (1) the majority might be selfish and dishonorable, refusing to vote for the basic institutional requirements for a just society, and (2) the majority might not have the taste for certain goods that would enrich social life and improve well-being.

The government may only choose to defer to private organizations in the second category. Even if the majority expresses a preference for inequality and exploitation, a just government cannot facilitate those things. The basic rights of individuals, and the institutions that are necessary to guarantee freedom and equality, cannot be subject to the wishes of the median voter. Government has a responsibility to provide basic public goods and to coerce an unwilling public into a fair distribution. Only after government has fulfilled its core responsibilities of guaranteeing just institutions can the majority choose to allocate functions to a fickle private sector.

C. A Rawlsian Model

John Rawls's theory of justice is helpful in thinking about the appropriate scope of charitable functions. His theory concerns the requirements for public institutions, so it directs attention to obligations of government. Under Rawls's conception of a just society, individuals must be guaranteed the liberties of equal citizenship and equality of opportunity. In his two basic principles of justice, Rawls provides that

each person is to have an equal right to the most extensive scheme of equal basic liberties compatible with a similar scheme of liberties for others The distribution of wealth and income, and positions of authority and responsibility, are to be consistent with both the basic liberties [of equal citizenship] and equality of opportunity.⁸⁷

87. See RAWLS, *supra* note 78, at 53–54.

To Rawls, the project of justice is achieved at the political level—his is a political theory. It is the job of political institutions to guarantee equality and freedom.⁸⁸ Anything necessary for an individual to enjoy equal citizenship and equal opportunity must be guaranteed by government. That obligation cannot be satisfied by delegation to a private organization that itself lacks an obligation to maintain the structure of a just society.⁸⁹ The basic structure of government is grounded in political principles of justice rather than appeals to emotion; the guarantee of basic rights cannot depend on altruistic impulses.⁹⁰

Rawls makes a distinction between a property-owning democracy and welfare-state capitalism,⁹¹ which is instructive in thinking about the division between the public and private sectors. Rawls rejects welfare-state capitalism in favor of property-owning democracy because “the background institutions of property owning democracy work to disperse the ownership of wealth and capital, and thus to prevent a small part of society from controlling the economy, and indirectly, political life as well.”⁹² This rejection of welfare-state capitalism is a rejection of explicit redistribution in favor of distribution. Where there is no pre-social entitlement, redistribution is not necessary. The background institutions, creation of which are the fundamental public obligation in Rawls’s theory, do all the work in achieving a just distribution of income and wealth.

A society in which private organizations are responsible for public goods and distribution is one in which concentrations of wealth and power are perpetuated by those very institutions. Too much responsibility in the hands of charitable organizations is inconsistent with a fair distribution by public institutions. Power is unjustly concentrated where private organizations are responsible for important public functions. Rawls has argued that the least advantaged should not be the object of compassion and charity, but are owed justice. Consequently, he rejects *ex post* redistribution by government, in favor of fair cooperation at the outset so that an underclass never develops. A just society does not need *ex post* redistribution because it provides *ex ante* opportunity. The goal of creating social institutions should be to create the conditions in which everyone can participate and where all individual contributions to the social product are recognized and valued.⁹³

Rawls is particularly concerned about excessive concentrations of power.⁹⁴ He is critical of excessive concentrations of wealth because of the effects that concentration might have on the political process.⁹⁵

88. See JOHN RAWLS, *JUSTICE AS FAIRNESS: A RESTATEMENT* 11 (Erin Kelly ed., 2001) (“[J]ustice as fairness is a political, not a general, conception of justice.”).

89. *Id.* at 10 (“The basic structure is the background social framework within which the activities of associations and individuals take place.”).

90. *Id.* at 77.

91. *Id.* at 139.

92. *Id.*

93. See *id.* at 140.

94. *Id.* at 44.

95. *Id.*

Consequently, a system in which the basic tools of citizenship are entrusted to private organizations would be problematic. For example, education, a prerequisite for equal opportunity, cannot be within the control of a small elite.

There is a role for private organizations in Rawls's theory. He makes clear that freedom of association is essential in a just society so that individuals can develop and exercise their moral powers.⁹⁶ Even where government effectively provides public goods and redistribution sufficient to guarantee equality and opportunity for all, there is substantial space for private organizations to further disparate ideas about the good. A public structure that guarantees citizenship nurtures private organizations with pluralistic goals, and so Rawls's theory is most consistent with the pluralism explanation for the nonprofit sector.⁹⁷ But those private organizations do something very different from governments. They serve a unique role in fostering social progress—a role particularly unsuited to government. Because each individual has a right to develop her own conception of the good, no government may impose a single ideal.⁹⁸ In developing individual conceptions, people need the opportunity to collaborate with others to better reach individual understandings of their own values. In this way, private associations like charities have a crucial role in individual moral development that government cannot fulfill.

Rawls includes the right to personal property among the basic rights. He understands, however, that the right of personal property to be instrumental to the fundamental goal of independence and self-respect.⁹⁹ His right to private property does not imply an entitlement to pre-tax income. Consequently, in designing actual institutions of society, we must consider how material needs affect the ability of individuals to be independent and self-respecting. The right to private property is not the starting point from which principles of justice are derived. Rather, private property can serve the goals of empowering individuals as equal citizens.

D. What Must Government Do?

Rawls's project endeavors to determine the terms of social cooperation. Individuals need to come together on terms of equality and mutual respect. Within the guarantees created by the basic structure, private organizations and the pluralism they promote can thrive. But what are the institutions

96. *Id.* at 45.

97. See Brody, *supra* note 63, at 244 (“Philanthropy is private precisely because society prefers reasonable discretion exercised by different participants under different conditions to the uniformity of government-directed action.”); see also Simon, Dale & Chisolm, *supra* note 36, at 275 (“A system that provides for diverse, decentralized decision making about which visions of public benefit merit support is well suited to a heterogeneous society, where many citizens prefer a supply of public goods—like culture, health, welfare, and protection of civil rights and the environment—that exceeds what majoritarian political processes will provide.”).

98. See RAWLS, *supra* note 88, at 18.

99. *Id.* at 114.

necessary to guarantee basic rights and liberties? What do individuals need to exercise equal citizenship and enjoy equality of opportunity?

At the very least, people need the basic minimums of food, clothing, and shelter. A person struggling to satisfy basic needs is in no position to exercise political rights and freedom of thought. The government must ensure these basics. This is precisely where the rhetoric of charity law goes completely wrong—those who would argue that charitable organizations should do more to address poverty excuse government from its most basic responsibility. It is only because government fails to do what a just government must do that we find ourselves in a world where private organizations fill the gap in providing basic social services. The social responsibility for a basic minimum is not only consistent with Rawls's theory, but it also has roots in G.W.F. Hegel's theory of property¹⁰⁰ and is essential to other philosophical conceptions of freedom. Philippe Van Parijs has made the basic minimum a cornerstone of his theory,¹⁰¹ and Amartya Sen's capability approach is built on the principle that individuals need the tools to exercise autonomy.¹⁰²

A basic minimum must include health care and education.¹⁰³ Under the first principle of justice, Rawls includes "the rights and liberties specified by the liberty and integrity (physical and psychological) of the person."¹⁰⁴ Since equality is at the core of Rawls's theory, the basic structure must ensure that the natural and social differences that individuals possess do not translate into disparate opportunities or outcomes.¹⁰⁵ Health care and education are key.

Distribution is an essential role of government. Just distribution is possible, but only if government is willing to use the coercive power of taxation to address inequality. Charities can assist in administering redistribution and can supplement public efforts, but the structure of charity under current law is completely unsuited to fully address the problem. Until markets are able to distribute the returns of social cooperation to everyone, government distribution will be necessary to account for the morally arbitrary returns to natural talents and social advantages.¹⁰⁶

E. What Does That Leave for Private Organizations?

The sphere for private organizations depends on what is left after the government fulfills its obligations. The traditional subsidy theory asks what public goods are produced in the private sector and then grants an

100. See G.W.F. HEGEL, PHILOSOPHY OF RIGHT 41–53 (1821).

101. See PHILIPPE VAN PARIJS, REAL FREEDOM FOR ALL: WHAT (IF ANYTHING) CAN JUSTIFY CAPITALISM? (1995).

102. See AMARTYA SEN, DEVELOPMENT AS FREEDOM (1999); Amartya Sen, Equality of What? (May 22, 1979), in THE TANNER LECTURE ON HUMAN VALUES, 1979, at 197 (1979).

103. See RAWLS, *supra* note 88, at 44 ("Society must also establish, among other things, equal opportunities of education for all regardless of family income.").

104. *Id.*

105. See Linda Sugin, *A Philosophical Objection to the Optimal Tax Model*, 64 TAX L. REV. 229, 264 (2011); see also RAWLS, *supra* note 78, at 72.

106. See RAWLS, *supra* note 78, at 72.

exemption where public benefits are produced privately. But it would be better to ask what government is not suited to do. Creative, original, and critical projects need protection from government pressure, orthodoxy, and funding. Private organizations are necessary to challenge and check government. Movements for social change, the arts, and religion are prime candidates for protection from government budgeting. As Rawls notes, “[A] democratic political society has no *such shared* values and ends apart from those falling under or connected with the political conception of justice itself.”¹⁰⁷ Consequently, a just society must leave room for private institutions to explore disparate values and goals because government is unable to do so. The Constitution forbids a state church, but rejection of a public orthodoxy in faith is the best reason for requiring that religion be private.

In a Rawlsian conception, pluralism is a political imperative, not an economic one. Fostering a broad set of choices about value is necessary if individuals are going to exercise freedom to determine what is meaningful in their lives. Government is in a poor position to compare incommensurable goals. In allocating resources to different projects, government must compare and value defense, education, health, environmental protection, et cetera along a single dimension. Government budgets must determine how much of a limited total to devote to any area. In that process, some clear public goals will receive less than they need. The ranking of importance for government responsibility must relegate certain purposes to the bottom. For example, government may legitimately prioritize health over other public goals on the theory that physical well-being is the most basic requirement of a stable economy and a democratic citizenry. The elevation of health is reasonable even if everyone also agrees that national defense and education are also important. More ephemeral goals are likely to lose out in these kinds of comparisons.

Private charity is the mechanism to avoid these direct comparisons. Resisting reduction to a single conception of value is crucial to a society rich in ideas and possibilities. Rawls’s imperative to allow each individual to determine what is meaningful in life demands this variety. In Rawlsian society, the state creates the infrastructure in which private activity can flourish. But that flourishing is varied, inconsistent, and necessarily private.

Some institutions need to be actively protected from government interference. The problem is not just that government will fail to fund them, but that government will actively abuse them. This is apparent in the arts and explains why the arts are more precarious as public institutions than as private institutions. The story of the Detroit Institute of the Arts (DIA) illustrates why cultural institutions need to be private: their assets need legal protection from government for them to exist. When Detroit’s recent financial difficulties peaked, its emergency manager considered

107. See RAWLS, *supra* note 88, at 20 (emphasis added).

selling off the DIA's collection to pay the city's debts,¹⁰⁸ which totaled approximately \$18 billion.¹⁰⁹ It was clear that the manager had the legal power to do so¹¹⁰ and many competing public interests to address. Government cannot be expected to compare pension needs to cultural preservation. The museum was ultimately saved by reverting to private nonprofit ownership and control.¹¹¹

Since private organizations play a crucial role in a just society, there is no reason to be ambivalent about their being private. Recognition of the unique value of private organizations should produce greater transparency about their private nature. If public institutions guarantee equality and freedom, there is no need to apologize for the private nature of charity by veiling it in a rhetoric of publicness. Donors can support anything they want, and they should be allowed to do so because a just society includes a substantial sphere of control for private organizations and includes private property as a basic right.¹¹² The argument that some charities are too rich is a non sequitur in a world in which charities are transparently private, individuals are sufficiently taxed to fund public obligations, and government fully funds its responsibilities.¹¹³

V. WHAT ABOUT THE TAX LAW?

Currently, the tax law bears tremendous pressure for instrumental social policies because the government fails to satisfy its basic responsibilities. If government better satisfied the demands described in Part IV by guaranteeing basic minimums—education and health—then the tax law of charity would be less important to justice. This part imagines a more circumscribed—and unabashedly private—function for charities that is nevertheless important.

A. Tax Law Should Favor Pluralism

The tax law should embrace charity *because* it is private and can therefore provide social benefits that government is ill-equipped to provide. Charity's basic institutional values are "freedom to try new and experimental programs, diversity of approaches, [and] multiple centers of

108. See Nathan Bomey, *Detroit Bankruptcy: A Master Time Line*, DETROIT FREE PRESS (Nov. 8, 2014), <http://www.freep.com/story/news/local/detroit-bankruptcy/2014/11/08/detroit-bankruptcy-timeline/18680129/> [https://perma.cc/Y3E2-JUX2].

109. See *id.*; Mark Stryker, *DIA in Peril: A Look at the Museum's Long, Tangled Relationship with Detroit Politics and Finances*, DETROIT FREE PRESS (Sept. 8, 2013) (on file with author).

110. See MICH. COMP. LAWS § 141.1552(r) (2013).

111. See Bomey, *supra* note 108; Randy Kennedy, *Detroit Art Museum Offers Plan to Avoid Sale of Art*, N.Y. TIMES (Jan. 29, 2014), http://www.nytimes.com/2014/01/30/us/detroit-art-museum-offers-plan-to-avoid-sale-of-art.html?_r=0 [http://perma.cc/6Y99-TNS8].

112. Rawls includes the right to hold property as a basic liberty. See RAWLS, *supra* note 88, at 114.

113. See *e.g.*, Victor Fleischer, *Stop Universities from Hoarding Money*, N.Y. TIMES (Aug. 19, 2015), <http://www.nytimes.com/2015/08/19/opinion/stop-universities-from-hoarding-money.html> [http://perma.cc/7DA7-FJW8].

initiative.”¹¹⁴ The opportunity to pursue and discuss innovative or new ideas in a private setting “offers a chance for participants who otherwise would be shut out of government or the market to take part in deliberative self-determination, a fundamental part of what it means to be human.”¹¹⁵ The social good in diversity arises only where it is private.¹¹⁶

Private charity is an important social good even if it does not relieve the burdens of government or achieve other broad public purposes. Society benefits from nonprofit organizations “not just because of what they do, but because of what they are, because their very existence is a guarantee of the diversity that protects the freedom of all of us.”¹¹⁷ Nonprofit organizations generate what Rob Atkinson has called metabenefits—“benefits that derive not from what product is produced or to whom it is distributed, but rather from how it produced or distributed.”¹¹⁸ The fostering of pluralism and the promotion of diversity are metabenefits that are inherently desirable.¹¹⁹ Justice Powell’s concurrence in *Bob Jones* is a powerful legal endorsement of pluralism over publicness. He argued that “private, non-profit groups receive tax exemptions because each group contributes to the diversity of association, viewpoint, and enterprise essential to a vigorous, pluralistic society.”¹²⁰ The pluralism justification for the charitable sector and its tax benefits best fits charity’s appropriate place in a just society.

B. Redesign the Charitable Deduction

Following from a policy based on pluralism, the charitable deduction can be more transparent about subsidizing private organizations. The language of the statute and the regulations could remove any reference to public purposes.¹²¹ In its place, they could substitute explicit support of organizations that challenge government and foster diverse values.

Alternatively, the charitable deduction could be replaced with a non-tax approach. Charitable gifts can be reported to the government, which could gross up private gifts with public funds paid directly to charity.¹²² The

114. See Albert M. Sacks, *The Role of Philanthropy: An Institutional View*, 46 VA. L. REV. 516, 526 (1960).

115. See Brian Galle, *The Role of Charity in a Federal System*, 53 WM. & MARY L. REV. 777, 789 (2012).

116. See RAWLS, *supra* note 88, at 5 (discussing pluralism).

117. John D. Colombo, *The Role of Access in Charitable Tax Exemption*, 82 WASH. U. L.Q. 343, 364–65 (2004) (citation omitted).

118. Atkinson, *Altruism in Nonprofit Organizations*, *supra* note 84, at 605.

119. See Simon, Dale & Chisolm, *supra* note 36, at 275 (“A system that provides for diverse, decentralized decision making about which visions of public benefit merit support is well suited to a heterogenous society.”).

120. *Bob Jones Univ. v. United States*, 461 U.S. 574, 609 (1983) (Powell, J., concurring).

121. See *supra* Part II.A.

122. This is the mechanism that the United Kingdom has adopted. See Income Tax (Earnings and Pensions) Act 2003, c. 1, § 713 (UK), <http://www.legislation.gov.uk/ukpga/2003/1/section/713> [<https://perma.cc/V2AR-HKCV>]. The British equivalent of the U.S. IRS explains the operation of its system on its website. See *Tax Relief When You Donate to a Charity*, HM REVENUE & CUSTOMS, <http://www.hmrc.gov.uk/individuals/giving/gift-aid.htm> (last visited Apr. 29, 2016) [<https://perma.cc/FRJ4-K694>]. It was proposed by the Bipartisan Policy Center in its comprehensive tax reform proposal. See

regime can be just as economically generous as current law, but without creating an entitlement to pre-tax income.¹²³ It could continue to steer government support to institutions chosen by taxpayers in proportion to their support.¹²⁴ Even if the amount and source of gifts received is information that the government needs to know for it to direct some of the revenue it collects, the government does not need to collect that information on tax returns, or from donors at all.

Transforming the deduction into a grant that is actually paid by governments directly to charities has practical and theoretical benefits. Separating individual taxpayers from the government subsidy to charity would address the bias in favor of private property and against taxation inherent in the current design of the charitable tax provisions. This design negates the message of entitlement to pre-tax income by ensuring that the government subsidy is not paid through the individual taxpayer. It establishes the nonsubstitutability of tax payments and charitable giving because tax liability does not change on account of charitable giving. A direct subsidy prevents possible donor capture that current law makes possible, increasing the benefit to charitable organizations.¹²⁵ As an added bonus, this redesign could get rid of some of the quirks of current law, like the upside-down subsidy and the deduction's unavailability to itemizers.¹²⁶

The corollary to this, of course, is that taxpayers should be required to pay tax, regardless of their charitable gifts, in keeping with a fair shares approach to taxation. Requiring taxpayers to pay tax on all income, without a reduction for charitable donations, refutes the implication that all the pre-tax income is properly in the dominion and control of the taxpayer. This is true even if the government subsidizes charities favored by donors to the same extent as under current law.

C. Tax Benefits for Charity Should Not Have a High Hurdle

The tax law of charity is too important. It institutionalizes the belief that private organizations can achieve public goals, and we depend on it for public goods and redistribution. If we instead focus on government, there is less pressure on the tax benefits for charity because there is less that charities *must* do. A more just society might—or might not—have fewer resources in the charitable sector, but it would certainly have more resources in the public sector. At the same time, there is little reason to deny tax benefits to private organizations, as long as those tax benefits do not suggest that private organizations can satisfy fundamentally public responsibilities.

BIPARTISAN POL'Y CTR., RESTORING AMERICA'S FUTURE: REVIVING THE ECONOMY, CUTTING SPENDING AND DEBT, AND CREATING A SIMPLE, PRO-GROWTH SYSTEM 34 (2010) (describing the credits for charitable contributions as going directly to the charitable institutions).

123. See *supra* Part III.B.

124. See generally Saul Levmore, *Taxes As Ballots*, 65 U. CHI. L. REV. 387 (1998).

125. See *supra* Part III.B.

126. See *supra* note 30 and accompanying text.

Because the IRC defines charities and carves out tax benefits for them,¹²⁷ the tax law places a heavy burden of justification on the charitable tax provisions; it frames the tax question as about charities. Lots of institutions and activities receive tax benefits, and the standard of public benefit for them is low. Charitable tax benefits should not have a higher burden of proof than tax benefits in other areas. In the business area, there are dubious public benefits for bonus depreciation, oil exploration, and investment in video games. In the individual area, there is no evidence that preferences for capital income produce greater investment and economic growth.¹²⁸ To the contrary, many tax benefits clearly undermine public values. The preference enjoyed by hedge-fund managers and the realization rule undermine equality. Tax benefits for fossil fuel exploration benefits and employee parking undermine environmental protection. Why single out charities for the highest scrutiny?

The scrutiny of charitable tax benefits is misplaced because tax benefits do not define charities. They make up a small part of total charity support; fees for services are the largest single source of funds for charities.¹²⁹ Volunteer time is valuable, though nonmonetary.¹³⁰ The after-tax cost of donations substantially exceeds the subsidy received from government as long as marginal tax rates remain relatively low. The tax exemption may provide no economic benefit at all,¹³¹ and the charitable deduction may be necessary to define income properly.¹³² The tax expenditure budget scores the charitable deduction so high because it ignores some of the most substantial benefits built into the tax system, like the realization rule and imputed income.¹³³

Since most of the resources in the nonprofit sector do not arise from tax benefits, the attention on tax subsidies is excessive. Scholars and courts treat the tax deduction for contributions as the most important legal hook for regulation, but it is really a relatively weak support for a growing regulatory structure.¹³⁴ Charities contribute to the excessive focus on the charitable deduction by treating any change—even ones likely to their benefit—as mortal threats.¹³⁵ If we lower the scrutiny level, it becomes

127. Only organizations that qualify under section 501(c)(3) are eligible for the most generous array of benefits, with deductible contributions under section 170 the most important.

128. JANE G. GRAVELLE, CONG. RESEARCH SERV., R40623, *TAX HAVENS: INTERNATIONAL TAX AVOIDANCE AND EVASION* (2015).

129. See *Quick Facts About Nonprofits*, NAT'L CTR. CHARITABLE STATS.: URB. INST. (2015), <http://nccs.urban.org/statistics/quickfacts.cfm> [<https://perma.cc/G734-HXVZ>].

130. See *id.*

131. Bitkker & Rahdert, *supra* note 26, at 302.

132. See William D. Andrews, *Personal Deductions in an Ideal Income Tax*, 86 HARV. L. REV. 309, 346 (1972).

133. See Linda Sugin, *Payroll Taxes, Mythology, and Fairness*, 51 HARV. J. ON LEGIS. 113, 127–30 (2014).

134. The IRS increasingly regulates the nonprofit sector. See Letter from Evelyn Brody to the IRS (Sept. 14, 2007), http://www.charitygovernance.com/charity_governance/files/brody-990-governance.pdf [<https://perma.cc/7YK5-Z6RR>].

135. Charities have opposed proposals to extend until April 15th the deadline for deductibility of charitable gifts. See C. EUGENE STEUERLE, TAX POLICY CTR.: URBAN INST. &

clear that the tax benefits for charity—in the scheme of the tax system as a whole—are reasonable given the important contributions of charities to diversity and freedom.

CONCLUSION

This Article has argued that the tax law of charity is important in creating a private property entitlement, challenging both the intuition that charity is altruistic and the rhetoric that charity is public serving. This perspective on charity demands a reassessment of the proper role of government compared to private institutions and leads to the conclusion that government cannot depend on private organizations to guarantee equality and freedom. The law of charity is not designed to ensure that charitable funds go to the neediest recipients or the most important social purposes. Nevertheless, charity—even as currently defined by law—is important and desirable, and tax benefits for it are easily justified in the current legal scheme. When government assumes greater responsibility for establishing just institutions, the expectation that charities will replace government underperformance may no longer be necessary.