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

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I. INTRODUCTION

State law has long regulated the conduct of charity fiduciaries,[1] in no small part by imposing fiduciary duties on these overseers of charitable

1. The academic literature discussing the state law regulation of charity fiduciaries is extensive. *See, e.g.*, 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); 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); Evelyn Brody, *Charity Governance: What's Trust Law Got to Do with It?*, 80 CHI.-KENT L. REV. 641 (2005); Evelyn Brody, *The Limits of Charity Fiduciary Law*, 57 MD. L. REV. 1400, 1406–14 (1998) [hereinafter Brody, *The Limits*]; Evelyn Brody, *Whose Public? Parochialism and Paternalism in State Charity Law Enforcement*, 79 IND. L.J. 937, 983 (2004) [hereinafter Brody, *Whose Public?*]; Nina J. Crimm, *A Case Study of a Private Foundation's Governance and Self-Interested Fiduciaries Calls for Further Regulation*, 50 EMORY L.J. 1093, 1133–44 (2001); Deborah A. DeMott, *Self-Dealing Transactions in Nonprofit Corporations*, 59 BROOK. L. REV. 131 (1993); James J. Fishman, *Improving Charitable Accountability*, 62 MD. L. REV. 218, 222 (2003); Susan N. Gary, *Regulating the Management of Charities: Trust Law, Corporate Law, and Tax Law*, 21 HAW. L. REV. 593, 609–15 (1999); Harvey J. Goldschmid, *The Fiduciary Duties of Nonprofit Directors and Officers: Paradoxes, Problems, and Proposed Reforms*, 23 J. CORP. L. 631, 632 (1998); Henry B. Hansmann, *Reforming Nonprofit Corporation Law*, 129 U. PA. L. REV. 497, 581 (1981); Henry Hansmann, *The Evolving Law of Nonprofit Organizations: Do Current Trends Make Good Policy?*, 39 CASE W. RES. L. REV. 807 (1988–89); Robert A. Katz, *Let Charitable Directors Direct: Why Trust Law Should Not Curb Board Discretion Over a Charitable Corporation's Mission and Unrestricted Assets*, 80 CHI.-KENT L. REV.

trusts and corporations.[2] Two widely recognized duties that a charity fiduciary owes the entity that she governs are the duty of loyalty and the duty of care (or prudent administration, in the case of a charitable trust).[3] To these duties, some commentators would add a third—a duty of obedience.[4] This article explores "obedience" norms under state law and analyzes the degree to which federal tax law does and should embrace various obedience norms.

The two widely acknowledged fiduciary duties of loyalty and care have fairly established meanings, even if there are disputes concerning the outer limits of their definitions.[5] Let us first consider the duty of loyalty. Under typical state law, the precise nature of the duty of loyalty owed by charity fiduciaries depends on whether the charity is organized as a trust or as a corporation.[6] Commonly, a director of a nonprofit charitable corporation must act in "good faith" and according to what she believes (or reasonably believes) is in the "best interests of the corporation."[7] When a

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689, 696 (2005); Geoffrey A. Manne, *Agency Costs and the Oversight of Charitable Organizations*, 1999 WIS. L. REV. 227, 229 (1999); Dana Brakman Reiser, *Director Independence in the Independent Sector*, 76 FORDHAM L. REV. 795, 796–79 (2007); Norman I. Silber, *Symposium: Who Guards the Guardians?: Monitoring and Enforcement of Charity Governance: Nonprofit Interjurisdictionality*, 80 CHI.-KENT L. REV. 613, 618 (2005); Linda Sugin, *Resisting the Corporatization of Nonprofit Governance: Transforming Obedience into Fidelity*, 76 FORDHAM L. REV. 893, 905 (2007); Jeremy Benjamin, Note, *Reinvigorating Nonprofit Directors' Duty of Obedience*, 30 CARDOZO L. REV. 1677, 1685 (2009); Denise Ping Lee, Note, *The Business Judgment Rule: Should It Protect Nonprofit Directors?*, 103 COLUM. L. REV. 925, 932–33 (2003).

2. *See* Lloyd Hitoshi Mayer & Brendan M. Wilson, *Regulating Charities in the Twenty-First Century: An Institutional Choice Analysis*, 85 CHI.-KENT L. REV. 479, 491 (2010) (observing that "there is general agreement that charity leaders owe their organizations two duties under state laws: care and loyalty"; further observing a duty of "obedience" that may not be entirely distinct from the other two).

3. One book succinctly explains as follows in describing the duties of directors of a nonprofit corporation. "The duty of care and the duty of loyalty are the common terms [to describe] the standards that guide all actions a director takes. These standards are derived from a century of litigation principally involving business corporations, but are equally applicable to nonprofit corporations." SECTION OF BUSINESS LAW, AM. BAR ASS'N, GUIDEBOOK FOR DIRECTORS OF NONPROFIT CORPORATIONS 19 (George W. Overton & Jeannie Carmedelle Frey eds., 2d ed. 2002). *See also* PRINCIPLES OF THE LAW OF NONPROFIT ORGANIZATIONS § 300 (Tentative Draft No. 1, 2007) [hereinafter PLNO] ("Each governing-board member shall in good faith exercise the fiduciary duty of loyalty . . . and care . . . .").

4. *See, e.g.*, DANIEL L. KURTZ, BOARD LIABILITY: GUIDE FOR NONPROFIT DIRECTORS 21 (1988); Sugin, *supra* note 1, at 897–905 (discussing the duty of obedience as commonly understood). For analyses of the scope and purpose of a duty of obedience, see Rob Atkinson, *Obedience as the Foundation of Fiduciary Duty*, 34 J. CORP. L. 43 (2008); Alan R. Palmiter, *Duty of Obedience: The Forgotten Duty*, 55 N.Y.L. SCH. L. REV. 457 (2010).

5. *See generally* Mayer & Wilson, *supra* note 2, at 491–93 (discussing fiduciary duties).

6. *See* Susan N. Gary, *Is it Prudent to be Responsible? The Legal Rules for Charities that Engage in Socially Responsible Investing and Mission Investing*, 6 NW. J.L. & SOC. POL'Y 106, 113 (2011).

7. *See, e.g.*, CAL. CORP. CODE § 5231(a) (West Supp. 2012) (requiring a director to act "in good faith, [and] in a manner that director believes to be in the best interests of the corporation"); MASS. GEN. LAWS ch. 180, § 6C (West 2012) (imposing a nearly identical standard); OHIO REV. CODE ANN. § 1702.30(B) (West 2009) (stating that a director must act "in good faith, [and] in a manner the director reasonably believes to be in or not opposed to the best interests of the corporation"); 15 PA. CONS. STAT. ANN. § 5712(a) (West 1995) (requiring a director to act "in good faith, [and] in a manner he reasonably

charity enters into a transaction with a director in which the director may personally profit, the duty of loyalty precludes her from profiting at the charity's expense.[8] Disinterested directors may also breach their duty of loyalty by intentionally conferring a financial benefit on an interested director to the detriment of the charity.[9] When the interests of a charitable nonprofit corporation conflict with the interests of directors and related persons, the duty of loyalty encourages directors to follow procedural safeguards.[10]

Under traditional law, trustees of charitable trusts are prohibited from engaging in self-dealing more rigidly than are corporate fiduciaries.[11] Under the Restatement (Third) of Trusts, "[e]xcept as otherwise provided in the terms of the trust, a trustee has a duty to administer the trust solely . . . in furtherance of its charitable purpose."[12] Accordingly, the duty of loyalty "strictly prohibit[s]" the trustee "from engaging in transactions that involve self-dealing or that otherwise involve or create a conflict between the trustee's fiduciary duties and personal interests" except in "discrete circumstances."[13] The duty of loyalty is breached even if "the action in question was taken in good faith, . . . the terms of the transaction were fair, and . . . no profit resulted to the trustee."[14]

Although traditionally the duty of loyalty governing fiduciaries varies depending on entity form, the dual standards may unite in time. The American Law Institute's Principles of the Law of Nonprofit Organizations (PLNO) seeks to merge fiduciary standards governing directors of nonprofit charitable corporations with standards governing trustees of charitable trusts.[15] Under PLNO, the duty of loyalty requires each director/trustee of

believes to be in the best interests of the corporation"); TEX. BUS. ORGS. CODE ANN. § 22.221(a) (West 2011) (imposing a similar standard).

8. *See* Mayer & Wilson, *supra* note 2, at 492.

9. *See, e.g.*, PLNO, *supra* note 3, §§ 365 cmt. c, illus. 1; 370 cmt. c(2), illus. 2.

10. *See, e.g.*, MODEL NONPROFIT CORP. ACT § 8.60(a) (3d. ed. 2008) [hereinafter MNCA (3d ed.)] (stating that a conflict-of-interest transaction is not voidable if, in relevant part, the board is informed of material facts and a majority of disinterested directors approve the transaction); § 8.31(a)(1)(ii) (stating that an interested director incurs no liability if one of the procedures of § 8.60 has been followed). Generally there is no outright prohibition against transactions between a director and the nonprofit corporation that she oversees. However, loans between a director or officer and the corporation that she oversees or manages are forbidden in states that follow the 1987 Revised Model Nonprofit Corporation Act. *See, e.g.*, REVISED MODEL NONPROFIT CORP. ACT § 8.32(a) (1987). An optional provision in the more recent model act generally forbids such loans. *See, e.g.*, MNCA (3d ed.) § 8.32(a).

11. *See* RESTATEMENT (THIRD) OF TRUSTS § 78 cmt. a (2007) ("The duty of loyalty is, for trustees, particularly strict even by comparison to the standards of other fiduciary relationships.").

12. *Id.* § 78(1) (2007); *see, e.g.*, *In re* Taylor Orphan Asylum, 36 Wis. 534, 552 (1875).

13. RESTATEMENT (THIRD) OF TRUSTS § 78(2) (2007).

14. *Id.* § 78 cmt. b (2007).

15. *See, e.g.*, PLNO, *supra* note 3, Reporter's Memorandum xxxiii ("Chapter 3 tries . . . to set forth a uniform set of rules of governance for both corporate charities and charitable trusts . . . ."); PLNO, *supra* note 3, Part II, Charities, Ch. 3, Topic 1, Intro. Note, at 17 ("[T]hese [p]rinciples apply uniform legal standards of loyalty and care to fiduciaries of all types of charities . . . ."); *id.* § 300, Comment on Subsection (a), a ("The term 'fiduciary'. . . generally embraces a trustee of a charitable trust, a member

any form of charity "to act in a manner that he or she reasonably believes to be in the best interests of the charity."[16] When the interests of a charity do or might conflict with the interests of directors and related persons, PLNO encourages directors to act in accordance with procedural safeguards analogous to those typical of nonprofit corporation statutes.[17]

The duty of care likewise enjoys a widely recognized general meaning. As articulated by PLNO, the duty of care requires a director to become adequately informed, to devote appropriate attention to overseeing the charity's affairs, and to act "with the care that an ordinarily prudent person would reasonably exercise in a like position and under similar circumstances."[18] Similarly, the Revised Model Nonprofit Corporation Act requires a director, in relevant part, to discharge her duties "with the care an ordinarily prudent person in a like position would exercise under similar circumstances."[19] These standards are largely consistent with those set forth in many nonprofit corporation statutes.[20] They are also similar to the traditional trust law analogue, the duty of prudent administration, which governs fiduciaries of charitable trusts.[21] Under the Restatement (Third) of Trusts, a trustee is required to "administer the trust as a prudent person would, in light of the purposes, terms, and other circumstances of the trust."[22] In administering the trust in compliance with this duty, the trustee generally must exercise "reasonable care, skill, and caution."[23]

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of the board of directors of a corporate charity, and anyone else serving a similar role.").

16. PLNO, *supra* note 3, at § 310(a).

17. *See, e.g.*, PLNO, *supra* note 3, at §§ 310(b), 330 (setting forth procedures for approving conflict-of-interest transactions sufficient to avoid a shift in the burden of proving a transaction's fairness to a defendant).

18. PLNO, *supra* note 3, at § 315 (a)–(b).

19. REVISED MODEL NONPROFIT CORP. ACT § 8.30(a)(2) (1988). Under the Model Nonprofit Corporation Act, Third Edition, directors "must discharge their duties with the care that a person in a like position would reasonably believe appropriate under similar circumstances." MNCA (3d ed.), *supra* note 10, § 8.30(b).

20. *See, e.g.*, CAL. CORP. CODE § 5231(a) (West. Supp. 2012) (requiring a director to act "with such care, including reasonable inquiry, as an ordinarily prudent person in a like position would use under similar circumstances"); MASS. GEN. LAWS ANN. ch. 180, § 6C (West 2011) (requiring a director to act "with such care as an ordinarily prudent person in a like position with respect to a similar corporation organized under this chapter would use under similar circumstances"); MICH. COMP. LAWS ANN. § 450.2541 (West Supp. 2012) (stating that a director must discharge her duties "with that degree of diligence, care, and skill which an ordinarily prudent person would exercise under similar circumstances in a like position"); N.Y. NOT-FOR-PROFIT CORP. LAW § 717(a) (McKinney 2011) (imposing an essentially similar standard); OHIO REV. CODE ANN. § 1702.30(B) (West Supp. 2012) (stating that a director must act "with the care that an ordinarily prudent person in a like position would use under similar circumstances"); 15 PA. CONS. STAT. ANN. § 5712(a) (West 1995) (requiring a director to exercise "reasonable inquiry, skill and diligence, as a person of ordinary prudence would use under similar circumstances"); TEX. BUS. ORGS. CODE ANN. § 22.221(a) (West 2011) (requiring a director to act "with ordinary care").

21. Gary, *supra* note 6, at 117–19.

22. RESTATEMENT (THIRD) OF TRUSTS § 77(1) (2007).

23. *Id.* § 77(2). If the trustee has "special facilities or greater skill than that of a person of ordinary prudence, [then] the trustee has a duty to use such facilities or skill." *Id.* § 77(3).

Whether charity fiduciaries are subject to a third duty, a distinct "duty of obedience," is a matter of some debate.[24] Part of the debate appears to originate from differing conceptions of the scope of the duties of loyalty and care,[25] whereas other aspects of the debate appear to stem from competing visions of the degree to which fiduciaries should be bound by their historic charter purposes, missions, or both. Further complicating matters are the various contexts in which an obedience norm is implicated and the form in which the charity operates (i.e., as a nonprofit corporation or charitable trust). The basic questions center upon whether—and, if so, under what circumstances and on account of what duty—charity fiduciaries must cause their charities to operate in accordance with the law, their charter purposes, and their precise missions (i.e., the specific charitable objectives that the charity has adopted to advance more general charter purposes).[26]

The purpose of this article is not to resolve the differing views of how best to understand and implement—or decline to implement—obedience norms under state law. Instead, this article surveys the basic legal and policy issues under state law, examines how federal tax law embraces or rejects various obedience norms, and discusses how federal tax law should be reformed so as to promote more effectively the elementary obedience norm that does feature prominently in federal tax law—the charity advancement norm.

Part II of this article lays out the basic categories of obedience norms that the law embraces, or that some believe the law should embrace. Part III analyzes the likely purposes of obedience norms and concludes that one purpose is primary. Part IV sketches the major features of federal tax law that implement one or more obedience norms: the fundamental exemption requirements and their associated judicial and administrative doctrines, the federal excise tax regime governing charities, and the unrelated business income tax (UBIT). Part V then evaluates the federalization of obedience norms under United States tax laws. Part V.A identifies various, and often conflicting, assumptions underlying the federal excise tax system. Part V.B discusses the federal interest in adopting obedience norms. Finally, Part V.C sets forth recommendations for reforming federal tax law to better advance legitimate federal interests.

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24. Most statutes and cases, however, do not articulate any such unique duty.

25. *See* Benjamin, *supra* note 1, at 1688 ("Commentators disagree as to whether the duty of obedience is a distinct duty, or is actually an aspect of the duties of care and loyalty.").

26. Distinguishing between a charity's specific mission and its charter purposes is common. *See* PLNO, *supra* note 3, § 320 cmt. e.

II. OBEDIENCE NORMS THAT DO OR COULD EXIST UNDER STATE LAW

This section of the paper sketches the obedience norms that do or may inform the nature of the fiduciary duties governing managers of charitable trusts and charitable nonprofit corporations. By no means does this paper offer a comprehensive doctrinal analysis of how state laws do and do not implement fiduciary obedience norms. Nor does this paper develop and defend a position on whether it is necessary or even helpful to articulate a "duty of obedience" that is distinct from the duty of loyalty and the duty of care/prudence.[27] Rather, this paper merely overviews how statutory laws, model and uniform acts, and case law impose, or decline to impose, various obedience norms on charity fiduciaries.

For purposes of analysis, this paper adopts a standard nomenclature distinguishing various conceptions of the obedience norm. This paper refers to a requirement that fiduciaries cause their charities to operate lawfully as the "legality norm." Requiring fiduciaries to ensure that a charity operates in accordance with its governing instrument—as it may be amended from time to time by the fiduciaries, the charity's members, or both, who may so act without first receiving substantive approval of the amendment from a governmental institution or official—is called the "dynamic charter fidelity norm." Requiring fiduciaries to ensure that a charity operates in accordance with its governing instrument—as it was originally drafted and as it may be amended only with the substantive approval of a governmental actor—is called the "static charter fidelity norm."[28] This paper refers to a requirement that fiduciaries cause their charities to operate in accordance with the charities' precise historic missions, which may be far more limited than the purposes for which a charity is expressly organized according to its governing instrument, as the "historic mission fidelity norm." The "dynamic mission fidelity norm" is a requirement that fiduciaries cause their charities to operate in accordance with the charities' precise charitable mission(s) as the governing board

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27. For those who are curious, I confess that I am skeptical of the doctrinal soundness and normative value of articulating a "duty of obedience" that is distinct from the fiduciary duties of care and loyalty in the case of fiduciaries governing incorporated charities.

28. Notwithstanding that this norm allows for amendments to a charity's governing instrument if a governmental actor approves them, it is appropriately described as "static" charter fidelity. Acting alone, fiduciaries bound by this norm cannot cause the charity to deviate from the terms of its governing instrument. Thus, from the perspective of fiduciaries who desire to amend the governing instrument but cannot obtain the necessary governmental approval to do so, the governing instrument is "static."

Of course, one could further distinguish between a "contingent static charter fidelity norm," which would permit charter amendments with judicial approval, and an "absolute static charter fidelity norm," which would never permit charter amendments in any circumstances. Because the latter does not exist in either trust law or nonprofit corporation statutes, this article simply adopts the more general nomenclature of the "static charter fidelity norm."

One could also distinguish between static charter fidelity norms according to varying degrees of judicial supervision over charter amendments. For present purposes, it is unnecessary to do so.

expands, contracts, or otherwise alters the mission(s) from time to time. Finally, this paper identifies a "charity advancement norm" and its negative corollary, both of which serve as elements or sub-norms of the other identified obedience norms.

A. Obedience Norms Governing Trustees of Charitable Trusts

The law of private trusts largely subsumes the norm of static charter fidelity, circumscribed by the legality norm.[29] Under the Restatement (Third) of Trusts, a trustee "has a duty to administer the trust, diligently and in good faith, in accordance with the terms of the trust and applicable law."[30] The official comments to this Restatement rule refer to the duty as the "normal duty of a trustee to obey the terms of the trust."[31] However, the law of private trusts also embraces the legality norm by invalidating terms of trust that are illegal[32] or contrary to public policy.[33] Moreover, a trustee of a private trust is not under a duty to comply with a trust provision that is unlawful or contrary to public policy,[34] and indeed is generally under a duty not to comply with such a provision.[35]

The law of charitable trusts also embraces both the legality norm and the static charter fidelity norm. It does so largely through the doctrine of cy pres, which allows trustees to deviate from the dispositive terms of a charitable trust only in limited circumstances, and only with advance judicial approval.[36] Under the traditional doctrine of cy pres,[37] a court may

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29. *See* RESTATEMENT (THIRD) OF TRUSTS §§ 1–2 (2003).

30. *Id.* § 76(1).

31. *Id.* § 76(1) cmt. b(1).

32. *See, e.g.*, RESTATEMENT (THIRD) OF TRUSTS § 29(a) (2003) (stating that a trust or trust provision is invalid if "its purpose is unlawful or its performance calls for the commission of a criminal or tortious act"); RESTATEMENT (SECOND) OF TRUSTS § 60 (1959) ("An intended trust or a provision in the terms of a trust is invalid if illegal."); *id.* § 61 ("An intended trust or a provision in the terms of the trust is invalid if the performance of the trust or of the provision involves the commission of a criminal or tortious act by the trustee.").

33. *See* RESTATEMENT (THIRD) OF TRUSTS § 29(c) (2003) (stating that a trust or trust provision is invalid if "it is contrary to public policy"); RESTATEMENT (SECOND) OF TRUSTS § 62 (1959) ("A trust or a provision in the terms of a trust is invalid if the enforcement of the trust or provision would be against public policy, even though its performance does not involve the commission of a criminal or tortious act by the trustee.").

34. *See* RESTATEMENT (THIRD) OF TRUSTS § 72 cmt. a (2003).

35. *See id.* § 72 cmt. b.

36. *See generally id.* § 67 (stating that if a charitable trust becomes unlawful, impossible or impractical to carry out, then a court will direct application of trust property or an appropriate portion thereof to a charitable purpose that approximates the designated trust purpose).

37. Closely related to the doctrine of cy pres is the doctrine of deviation (or "equitable deviation"). This latter doctrine empowers a court to direct a trustee of a charitable trust to deviate from the administrative terms of a trust if compliance with the original terms is impossible or illegal, or if compliance with the terms of trust would substantially impede the accomplishment of trust purposes on account of circumstances that the settlor did not foresee. *See* RESTATEMENT (THIRD) OF TRUSTS § 66(1) cmt. c (2003) (expanding the doctrine to authorize deviation from terms that are not merely administrative); RESTATEMENT (SECOND) OF TRUSTS § 381 cmt. a (1959). *See, e.g.*, MacCurdy-

direct charity fiduciaries to apply charitable trust funds to purposes similar to the original trust purposes when accomplishing the original purposes becomes impossible, impracticable, or illegal, as long as the transferor of the funds has manifested an intent to devote the funds to charitable purposes more general than the frustrated specific charitable purpose.[38] The Restatement (Third) of Trusts and the Uniform Trust Code alter the traditional common law doctrine of cy pres by adding wastefulness to the grounds for applying the doctrine and presuming that a donor possesses general charitable intent, but they otherwise follow the traditional doctrine of cy pres.[39]

Thus, absent the failure of original charitable purposes on grounds of illegality, impossibility, impracticability, or wastefulness, trustees of charitable trusts may not deviate from the express charitable purposes for which the settlor created the trust.[40] Indeed, trustees must petition a court to obtain permission to deviate from the express charitable purposes even when they believe the grounds for applying cy pres exist.[41] The default rules governing charitable trusts thereby adopt the static charter fidelity norm as well as the legality norm.[42]

Salisbury Educ. Fund v. Killian, 309 A.2d 11, 13–14 (Conn. Super. Ct. 1973) (applying the doctrine of deviation to minimize adverse federal excise tax consequences of accumulating trust income; distinguishing the doctrine of deviation from the doctrine of cy pres).

38. *See* RESTATEMENT (SECOND) OF TRUSTS § 399 (1959). *See, e.g.*, Sharpless v. Medford Monthly Meeting of the Religious Soc'y of Friends, 548 A.2d 1157, 1160 (N.J. Super. Ct. App. Div. 1988). *Cf.* GEORGE G. BOGERT & GEORGE T. BOGERT, THE LAW OF TRUSTS AND TRUSTEES § 438 (Rev. 2d ed. 1991) (stating that the doctrine applies when, in relevant part, furthering the donor's specific intent "is or becomes impossible, impractical, or inexpedient"); AUSTIN W. SCOTT ET AL., 6 SCOTT AND ASCHER ON TRUSTS § 39.5.2 (2010) [hereinafter SCOTT AND ASCHER ON TRUSTS) (stating that cy pres may be applied when it "is unlawful, impossible, impracticable, or wasteful to carry out" the settlor's particular charitable purposes). The doctrine is sometimes articulated as involving three prongs: (i) property is gratuitously transferred in trust for a designated charitable purpose; (ii) carrying out the designated purposes of the gift is, or becomes, impossible, impracticable, or illegal; and (iii) the trustor manifested a general intention to devote the gifted property to charitable purposes. *See* 15 AM. JUR. 2D CHARITIES § 149 (2002)*; see generally* 6 SCOTT AND ASCHER ON TRUSTS § 39.5 (discussing the cy pres doctrine).

39. RESTATEMENT (THIRD) OF TRUSTS § 67 cmt. b, *Reporter's Notes on § 67, cmt. b* (2003) (describing the modern rule as "displacing the traditional quest for a settlor's 'general charitable intent' when the trust" is silent); UNIF. TRUST CODE § 413 (2005).

40. *See supra* text accompanying notes 36–39.

41. *See* RESTATEMENT (THIRD) OF TRUSTS § 67.

42. *See supra* note 28 and accompanying text. Whether mission fidelity norms and charity advancement norms should apply to charitable trusts and corporations is an issue whose resolution seems to require no distinction between the form of the charitable entity. Accordingly, this article reserves a discussion of these norms until Part I.B.

B. Obedience Norms Governing Directors of Charitable Nonprofit Corporations

The typical nonprofit corporation statute imposes no express "duty of obedience" on directors of charitable corporations.[43] Nonetheless, state nonprofit laws embrace a variety of obedience norms. First, nonprofit entities, like other entities, are typically required to act in accordance with the law.[44] Fiduciaries who deliberately cause the entity to act unlawfully would generally breach their statutory fiduciary duties.[45] Consequently, state nonprofit corporation laws embrace the legality norm.

State nonprofit corporation laws also adopt norms of charter fidelity. Directors of a nonprofit charitable corporation must not cause the entity to act contrary to its corporate purposes.[46] Thus, in Texas, the state attorney general may sue to enjoin any such action, and a corporation may sue a director who causes a corporation to act outside of its corporate purposes.[47] Similarly, the 1987 Revised Model Nonprofit Corporation Act and the more recent Model Nonprofit Corporation Act, Third Edition, permit certain lawsuits when a corporation is alleged to have acted outside of its powers.[48] Therefore, both model acts implicitly require directors to obey their corporate charters (i.e., to govern so as not to cause the corporation to commit an *ultra vires* act).[49]

Nonetheless, state statutes generally do not disable directors.[50] State nonprofit corporation statutes typically permit amendments to corporate charters, including purposes clauses, as long as the proper internal procedures are followed.[51] In other words, the typical nonprofit corporation statute does not literally forbid members or directors from changing the historic purposes of an incorporated charity;[52] however, implementing desired mission changes that deviate from stated charter purposes first

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43. *See, e.g.*, TEX. BUS. ORGS. CODE ANN. § 22.221(a) (West 2011) (setting forth fiduciary standards governing directors).

44. *See, e.g.*, TEX. BUS. ORGS. CODE ANN. § 2.003(1)(A) (West 2011) (stating that a domestic entity may not engage in an "activity that is expressly unlawful or prohibited by a law of this state").

45. *See, e.g.*, *id.* § 22.221.

46. *Cf.* TEX. BUS. ORGS. CODE ANN. § 2.113 (West 2011) (stating that the statutory section specifying a domestic entity's powers "does not authorize a domestic entity or a managerial official of a domestic entity to exercise a power in a manner inconsistent with a limitation on the purposes or powers of the entity contained in its governing documents, this code, or other law of this state").

47. *See* TEX. BUS. ORGS. CODE ANN. § 20.002(c)(2), (c)(3)(B) (West 2011).

48. *See, e.g.*, MNCA (3d ed.), *supra* note 10, § 3.04; REVISED MODEL NONPROFIT CORP. ACT § 3.04 (1987).

49. *See* Fishman, *supra* note 1, at 237.

50. *See, e.g.*, TEX. BUS. ORGS. CODE ANN. § 22.105–.107 (West 2011).

51. *See, e.g.*, *id.* § 22.105 (specifying procedures for amending the certificate of formation for a corporation with members having voting rights); § 22.106 (specifying procedures for amending the certificate of formation for a corporation whose management is vested in members); § 22.107 (specifying procedures for amending the certificate of formation by the board of directors).

52. *See* Katz, *supra* note 1, at 696–98.

requires amending the purposes clause of the entity's charter in accordance with law.[53] Thus, state nonprofit statutes commonly appear to embrace the dynamic charter fidelity norm. There are exceptions, however.[54] For example, in New York, amendments to the purposes clause in a charity's corporate charter require judicial approval.[55] Accordingly, New York implements the static charter fidelity norm.

Like many states, PLNO embraces the dynamic charter fidelity norm.[56] Under PLNO, a charity fiduciary must cause the charity to obey the law and charter purposes, but fiduciaries are free to amend the entity's charter purposes in accordance with the procedures set forth by state laws governing amendments.[57] The comments to PLNO state as follows:

> Some commentators place the obligation to obey the law and the organizational documents and policies under a third duty unique to charity fiduciaries—the "duty of obedience." Substantively, to these commentators, such a duty embraces a faithfulness to the purposes of the charity. These Principles, however, do not employ the terminology of a duty of obedience. While the members of the governing board must adhere to the organizational documents, they also have the obligation to keep the purpose of the charity current and useful. Accordingly, the board must amend the stated purposes when necessary and appropriate to do so, in accordance with the law and the existing organizational documents.[58]

PLNO provides that—if charter purposes are so amended—general, unrestricted funds held by the charity may be used to advance post-amendment purposes.[59] PLNO thereby embraces the dynamic charter fidelity norm.

Although state nonprofit corporation statutes typically enable a charity's governing board to amend its charter purposes without first obtaining permission from a governmental actor, to conclude that state law consistently embraces the dynamic charter fidelity norm would be a mistake. The law is more richly textured. In certain contexts, some courts appear to have embraced the more rigid static charter fidelity norm.[60]

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53. See the statutory sections cited in note 51.

54. For a discussion of how some states have limited the ability of nonprofit hospitals to change their historic purposes, see Brody, *The Limits*, *supra* note 1, at 1465–76.

55. *See, e.g.,* N.Y. NOT-FOR-PROFIT CORP. LAW § 804(a)(ii) (McKinney 2011) (requiring further that the state attorney general receive notice of an application for judicial approval of the charter amendment).

56. *See, e.g.,* PLNO, *supra* note 3.

57. *Id.*

58. *Id.* § 300 cmt. g(3) (cross-referencing sections 240 and 320).

59. *Id.* § 245 (preliminary draft).

60. *See, e.g.,* *In re* Manhattan Eye, Ear & Throat Hosp. v. Spitzer, 715 N.Y.S. 2d 575, 594–97 (N.Y. Sup. Ct. 1999).

Indeed, resolution of a variety of legal issues requires acceptance or rejection of the static charter fidelity norm.

Consider, for example, the issue of whether a charity may use assets held prior to a charter amendment—and assets received as substitutes or replacements for such pre-amendment assets—to further post-amendment purposes. One can imagine an infinite number of fact patterns raising this issue. The simplest fact pattern involves a charity that amends its charter purposes and then seeks to use all of its existing assets, as well as changes in the form of those assets over time, to further the amended corporate purposes. Perhaps a private foundation organized primarily to support education desires to amend its purposes so that it can primarily advance religion. In such a case, all that essentially changes is the grantee base; the day-to-day operations and assets largely remain the same. More complicated fact patterns are also possible, however. Imagine a corporation that is: (1) organized to operate as a church; (2) located on valuable downtown land; and (3) governed by a board that desires to convert the church into an art museum operating in the suburbs. To accomplish the transformation, the charity must amend its corporate charter, sell its valuable real estate, obtain new facilities at another location, and operate in a completely different manner.

A law that prohibits a charity from using its assets (and replacements thereof) held prior to the charter amendment to further post-amendment purposes implements the static charter fidelity norm as to pre-amendment funds and their substitutes. Even if such a law permits the charity to modernize its purposes without governmental approval, to restrict funds held prior to the charter amendment to pre-amendment purposes is to embrace the static charter fidelity norm as to those assets. Contrary to the rule embraced by PLNO,[61] a few judicial authorities appear to embrace the static charter fidelity norm in this context.[62]

A similar issue is whether a charity desiring to terminate its existence may, pursuant to a plan of dissolution, transfer its assets to a charity having purposes dissimilar to those expressed in its charter. Some state statutes require dissolving charities to distribute assets to organizations having charitable purposes similar to those of the dissolving entity.[63] Other statutes are silent on the question or provide simply that the corporation must distribute its assets to other tax-exempt charities or governmental bodies (as Texas law now provides).[64] If the state statute governing distributions in

61. *See* PLNO, *supra* note 3, § 245 (preliminary draft).

62. *See, e.g.*, *In re Manhattan Eye*, 715 N.Y.S.2d at 594–97 (applying a statutory provision requiring judicial approval of the sale of substantially all of an entity's assets; relying on a charity fiduciary's "duty of obedience"); Attorney Gen. v. Hahnemann Hosp., 494 N.E.2d 1011, 1021 (Mass. 1986) (observing in dicta the problems of allowing a nonprofit corporation to use pre-amendment assets to further post-amendment purposes).

63. *See, e.g.*, N.Y. NOT-FOR-PROFIT CORP. LAW § 1002-a(c)(1) (McKinney 2011).

64. *See, e.g.*, TEX. BUS. ORGS. CODE ANN. § 22.304(a)(2) (West 2012).

dissolution expressly requires the dissolving entity to transfer assets to other charities having purposes similar to the longstanding express purposes of the dissolving entity, the statute can be said to at least partially embrace the static charter fidelity norm. The transferee must devote assets received from the dissolving entity in accordance with the transferee's charter—one that sets forth purposes similar to those of the dissolving entity's charter. In effect, because the two entities have similar charter purposes, such a state statute requires partial fidelity to the dissolved entity's charter (albeit vicariously). If the state statute does not literally require a dissolving entity to distribute assets only to a charitable transferee with specific purposes similar to those of the transferor, a court must decide whether to employ common law trust concepts to compel such a result. The (questionable) rationale of some judicial authority suggests that a court should do just that.[65]

Unfortunately, neither the 1987 Revised Model Nonprofit Corporation Act nor the more recent Model Nonprofit Corporation Act, Third Edition, clarifies when a court should employ the static charter fidelity norm.[66] Under these model nonprofit corporation statutes, "obedience" to the corporate charter does not foreclose amendments to charter purposes.[67] However, each act does contemplate limitations on a corporation's ability to redeploy funds from their originally intended uses following an amendment of charter purposes. The 1987 model act states that a charter amendment does not affect "any requirement or limitation imposed upon the corporation or any property held by it by virtue of any trust upon which such property is held by the corporation."[68] However, the 1987 model act offers no definitive guidance as to whether an otherwise unrestricted gift to a charitable corporation is impressed with a charitable trust governed by the corporation's charter purposes at the time of the gift.[69]

The more recent model nonprofit corporation act creates a broader limitation with peculiar optional language, which states as follows:

> Property held in trust by a nonprofit corporation or otherwise dedicated to a charitable purpose may not be diverted from its purpose by an amendment of its articles of incorporation unless the corporation obtains an appropriate order of [*the court*] [*the attorney general*] to the extent

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65. *See, e.g.*, Blocker v. State, 718 S.W.2d 409, 415–16 (Tex. App.—Houston [1st Dist.] 1986, writ ref'd n.r.e.) (construing a statutory provision requiring distributions in dissolution to transferees having purposes similar to those of the dissolving entity and deeming donations to a charitable corporation as gifts restricted to the corporate purposes of the donee at the time of the donations).

66. MODEL NONPROFIT CORP. ACT (3d. ed. 2008); REVISED MODEL NONPROFIT CORP. ACT (1987).

67. *See, e.g.*, REVISED MODEL NONPROFIT CORP. ACT § 10.01–.31 (1987).

68. *Id.* § 10.08.

69. At least one commentator argues that the model act "nowhere requires the use of general funds for pre-amendment purposes only." Katz, *supra* note 1, at 697.

> required by and pursuant to the law of this state on cy pres or otherwise dealing with the nondiversion of charitable assets.[70]

Like its 1987 counterpart, this provision is cryptic and appears to raise more questions than it answers.[71] Is a gift to a nonprofit charitable corporation property held in trust under the theory that charter purposes impress donations with a charitable trust? Perhaps the answer is "not necessarily," because the act contemplates that the corporation can hold property "otherwise dedicated to a charitable purpose."[72] But even with property otherwise dedicated to a charitable purpose, the model act forbids diversion of such property "from its purpose by an amendment of its articles of incorporation" absent prior authorization from a court or the state attorney—if state law requires such authorization.[73] Are not all assets held by a charitable corporation—even assets received with no donor-imposed restrictions—"dedicated to a charitable purpose?" If so, such assets are treated the same as assets held in trust under this provision.[74] Alas, it is unclear what the treatment is under the new model act, because governmental approval of any post-amendment redeployment of charitable assets is needed only "to the extent required by and pursuant to the law of this state on cy pres or otherwise dealing with the nondiversion of charitable assets."[75] When does state law require such approval? The model act does not provide the answer. Apparently, the "law of this state"[76] (as the phrase is used in the model act) means state case law. Accordingly, in a jurisdiction adopting the Model Nonprofit Corporation Act, Third Edition, one must determine whether the case law of the state embraces the static charter fidelity norm.[77] The model act itself punts on the issue.

The historic mission fidelity norm has received at least modest judicial recognition,[78] although it is very difficult to discern the degree of impact

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70. MNCA (3d ed.), *supra* note 10, § 10.09(b). A similar provision states as follows:

> Unless a nonprofit corporation obtains an appropriate order of [*the court*] [*the attorney general*] under the law of this state on cy pres or otherwise dealing with the nondiversion of charitable assets, an amendment of its articles of incorporation may not affect:
>
> (1) any restriction imposed upon property held by the corporation by virtue of any trust under which it holds that property; or
>
> (2) the existing rights of persons other than its members.

Id. § 10.09(c).

71. *See id.* § 10.09(b)–(c).

72. *Id.* § 10.09(b).

73. *Id.*

74. *See id.*

75. *Id.*

76. *Id.*

77. *See supra* text accompanying note 28.

78. *See, e.g.*, *In re* Manhattan Eye, Ear & Throat Hosp. v. Spitzer, 715 N.Y.S.2d 575, 593 (N.Y. Sup. Ct. 1999) ("It is axiomatic that the Board of Directors is charged with the duty to ensure that the mission of the charitable corporation is carried out."); *id.* at 595 (stating that deviating "from the charity's central and well-understood mission should be a carefully chosen option of last resort").

that it has had on that case law independent of the static charter fidelity norm.[79] The two norms are theoretically distinct because a charity's specific historic mission (e.g., operating an acute care hospital) may be more specific than the express purposes set forth in the charity's corporate charter (e.g., advancing charity through the provision of health care services).[80] A court seeking to bind fiduciaries to the charity's precise historic mission would likely seek to justify its position by invoking the probable expectations of donors familiar with the charity's work at the time of making their donations. Although this rationale is suspect in the opinion of the author,[81] it explains why a judge might consider imposing the historic mission fidelity norm in some contexts.

There is some academic support for an alternative to the historic mission fidelity norm—the dynamic mission fidelity norm.[82] Professor Linda Sugin articulates her version of this concept of obedience as follows:

> [T]he law should include a legal requirement that directors commit themselves to an organization's charitable mission. I describe that obligation as fidelity, in order to separate it from the traditional notion of obedience to the purposes stated in an organization's documents. Unlike the trust law notion, obedience is a flexible obligation that empowers directors to decide the course an organization will take. This duty incorporates a board's power to change the purposes or the mission statement of the organization and never requires a board's obedience to an outworn purpose in place of dynamic and responsive decision making. Nevertheless, I believe that some legal requirement is necessary and important because, without it, there is nothing in the law of nonprofit governance that affirmatively requires directors to strive for charitable goals.[83]

Professor Sugin's proposed duty of "fidelity" to a charity's mission implements the dynamic mission fidelity norm.[84] She rejects the "rigid connotations attached" to a technically narrow duty of obedience[85] and disapproves of "[r]equiring adherence to a fixed mission."[86] Professor Sugin would, in appropriate circumstances, permit governing fiduciaries to

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79. For example, *In re Manhattan Eye* involved a case in which the specific mission of the charity was articulated in the purposes clause of its articles of incorporation. *See id.* That fact did not escape the attention of the court. *See id.* at 595 (referring to the charity's "mission, as stated in its certificate of incorporation").

80. *See generally id.* at 593–95 (discussing a charity's mission).

81. *See infra* Part III; *see also* discussion *supra* Part II (prior to II.A) (discussing the historic mission fidelity norm).

82. *See* Sugin, *supra* note 1, at 904–05.

83. *Id.*

84. *See id.*

85. *Id.* at 903.

86. *Id.* at 904.

alter the specific mission of their charity, but would also require them to affirmatively advance whatever charitable mission they adopted.[87]

Several of these norms can comfortably co-exist, whereas others cannot. The legality norm is consistent with every other norm although it may limit express charter purposes. One cannot choose the dynamic charter fidelity norm and the static charter fidelity norm, or the historic mission fidelity norm and the dynamic mission fidelity norm, in any given context. However, to embrace the static charter fidelity norm does not necessarily require adoption of the historic mission fidelity norm; as long as a proposed change in mission is consistent with broadly worded charter purposes, the mission change is lawful. The static charter fidelity norm would limit the range of options available to directors seeking to alter a charity's mission, but it would not technically require adherence to the charity's current mission.[88] Alternatively, to embrace the dynamic charter fidelity norm virtually requires rejection of the historic mission fidelity norm in the same context; if directors are not free to alter the charity's mission, it makes little sense to empower them to alter more general charter purposes. Finally, norms that are mutually exclusive in the same context are not necessarily mutually exclusive when applied in different contexts. Thus, one theoretically can embrace the dynamic charter fidelity norm in the context of approving charter amendments, but favor the static charter fidelity norm as applied to the use of pre-amendment funds held by the charity or as applied to distributions in liquidation of the charity.

A final observation, however obvious, merits articulation. The two charter fidelity norms and the two mission fidelity norms require fiduciaries to ensure that their charities actually operate to further charitable purposes. Certainly, at any point in time, the choices available to charity fiduciaries, as they seek to specify the charitable path for their entities, are determined in part by state law's imposition of charter fidelity and mission fidelity norms. The specificity and mutability of charitable purposes tend to vary among the obedience norms.[89] Nonetheless, these norms have a common requirement: that charity fiduciaries act so as to advance charitable purposes. In other words, all norms require fiduciaries to "propel" charities in a general charitable direction.[90] Thus, a constitutive norm underlying all of these charity fiduciary obedience norms may be called the "charity

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87. *See id.* at 905, 911.

88. This conclusion holds unless the charter purposes are so detailed that they effectively define the specific mission of the charity.

89. *Id.*

90. Strictly speaking, there are two elements of the advancement required of charity fiduciaries. The first is to prompt charity fiduciaries to cause the charity to *advance a purpose*. The second element is to prompt charity fiduciaries to ensure that the purpose that the charity advances is indeed *charitable*. The former may be likened unto propelling the charity, whereas the latter may be likened unto pointing the charity in the right direction. Further "steering" or "guiding" of the charity occurs as fiduciaries comply with the governing charter fidelity and mission fidelity norms.

advancement norm." In addition to imposing a mandate on fiduciaries to advance some charitable purpose, the charity advancement norm has a negative corollary: charity fiduciaries must not act so as to advance a non-charitable purpose. To advance a non-charitable purpose would preclude adherence to every fidelity norm (i.e., dynamic charter fidelity, static charter fidelity, historic mission fidelity, and dynamic mission fidelity) identified herein. Also, insofar as operating illegally is inconsistent with qualification as a charitable entity,[91] the legality norm and the negative corollary of the charity advancement norm reinforce one another.

This brief discussion of obedience norms that govern—or that have been asserted or proposed to govern—charity fiduciaries is not intended to describe what the law should be or even to evaluate the extent to which certain obedience norms of questionable merit have garnered judicial acceptance. Rather, the point of the discussion is to identify the various conceptions of obedience that find at least some expression in statutory and case law or in legal commentary. Identifying these conceptions of obedience helps one to analyze whether and how federal tax law does and should encourage charity fiduciaries to adhere to obedience norms.

III. THE PURPOSE OF OBEDIENCE NORMS

At a very basic level, obedience norms perform a dual function: they restrain charity fiduciaries from causing charities to pursue objectives that the law deems improper, and they prompt charity fiduciaries to cause charitable entities to pursue objectives that the law deems appropriate. The legality norm primarily serves the former function. The foundational charity advancement norm, the two versions of the charter fidelity norm, and the two versions of the mission fidelity norm perform both functions. Deciding whether to apply the dynamic charter fidelity norm or the static charter fidelity norm—and further, whether to apply one of the mission fidelity norms—requires one to have in mind criteria for determining what charitable objectives are "appropriate." The most sensible of the criteria relate to the precise purposes for obedience norms. It is therefore incumbent upon the analyst to explore the ends that various obedience norms may help achieve.

Admittedly, to speak of the "purposes" of obedience norms as though such purposes are self-evident or pre-existing is misleading. It is better to speak of purposes that one should consider as possibly worthy of advancing through obedience norms. Accordingly, in the discussion that follows, I discuss some purposes that one might seek to advance through imposing obedience norms on charity fiduciaries. From the outset, I wish to emphasize that the following discussion is preliminary and, by design,

91. *See supra* notes 36–39, 44–45 and accompanying text.

conjectural. It is intended as a brief survey and assessment of the purposes that some might think are worth pursuing. The discussion is offered not as a definitive or comprehensive assessment, but as an exploratory inquiry.

A. Public Benefit

Probably the most fundamental purpose of obedience norms is to ensure that charitable entities benefit the public.[92] A "charitable purpose" is one that the law considers to benefit the public.[93] Under the assumption that the law is correct in identifying charitable purposes, to require fiduciaries to advance charitable purposes is thus to require them to govern their charities so as to benefit the public. Even if, in any particular case, a "charitable" entity generates dubious public benefits, the fact remains that the intention for that charity is to benefit the public. Hence, one may identify the "public benefit purpose" as the most elementary purpose of obedience norms. The foundational charity advancement norm is intended to serve this purpose, even by definition. Both the dynamic charter fidelity norm and the static charter fidelity norm tend to further this goal as well. Each compels directors of charitable nonprofit corporations to govern to promote compliance with the corporate charter; this requires the corporation to advance "charitable," as opposed to non-charitable, purposes.[94] To the extent that a charity's mission faithfully implements charter purposes, the two mission fidelity norms also reinforce this goal. Even the legality norm advances the public benefit purpose, albeit indirectly, by prohibiting unlawful activity, which itself is inconsistent with the concept of charity (and hence public benefit) under the common law of charitable trusts.[95]

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92. *Cf.* Sugin, *supra* note 1, at 913–18 (discussing the public interest in a charity's fulfillment of its mission).

93. *See, e.g.*, RESTATEMENT (THIRD) OF TRUSTS § 28(f) (2003) (stating that charitable trust purposes include "other purposes that are beneficial to the community"); *id.* cmt. a ("The common element of charitable purposes is that they are designed to accomplish objects that are beneficial to the community—i.e., to the public or indefinite members thereof—without also serving what amount to private trust purposes . . . .").

94. *Cf.* Fishman, *supra* note 1, at 239 n.148 ("Since the duty of obedience requires the directors to uphold the organization's founding documents, which require the organization to operate for a charitable purpose, operating for non-exempt purposes would be an ultra vires activity."). Certainly, the typical nonprofit corporation statute authorizes a nonprofit corporation to have purposes broader than those the law recognizes as "charitable." However, because corporations organized for charitable purposes are typically incorporated under nonprofit corporation statutes that require compliance with charter purposes, it is accurate to state that a charity's compliance with its charter requires that it serve a charitable purpose.

95. *See supra* text accompanying notes 36–39.

B. Reliance-Based Equity

Other possible purposes of obedience norms are more contestable. One such purpose may be to protect the reliance interest of donors[96] according to a notion of fair dealing.[97] To endorse this purpose is to argue that those who donate to a charity have chosen to part with their money because they support the particular charitable operations conducted by the charitable donee, and that allowing charity fiduciaries to change the nature of the charity's operations at will after the charity has received such donations is unfair to those donors. I will refer to this asserted purpose of obedience norms as the "reliance-based equity purpose." One who champions the reliance-based equity purpose of obedience norms would view the charity advancement norm as incomplete. Further, a proponent of reliance-based equity would often favor the static charter fidelity norm over the dynamic charter fidelity norm, because the latter enables directors of a nonprofit charitable corporation to alter charter purposes with no governmental approval. Such a proponent would also embrace the historic mission fidelity norm because many donors base their expectations of how a charitable donee will use donations on what the charity actually has done over an observable period rather than on what it says it can do in its corporate charter.

Although the reliance-based equity purpose has some intuitive appeal, it is at least problematic as applied to charitable corporations. Those who contribute to charitable trusts would properly assume that the trust's charitable purposes will remain largely unchanged.[98] Donors are less likely to assume (or should be less likely to assume) that a charitable corporation's purposes will remain unaltered.[99] As previously stated in this article, nonprofit corporation statutes typically enable charter amendments with ease and with no ex ante substantive governmental approval.[100]

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96. One can articulate a similar argument that centers on the reliance interests of stakeholders other than donors, such as members of the charitable class benefitted by the charity, public entities, and other charitable organizations who plan their activities in part with reliance on the existence and nature of the operations of the charity desiring to change its operations.

97. *Cf., e.g.*, Attorney Gen. v. Hahnemann Hosp., 494 N.E.2d 1011, 1021 (Mass. 1986) (stating in dicta that, if a corporation could use pre-charter-amendment donations to further post-amendment purposes, then "[t]he public could not be assured that funds it donated would be used for similar public charitable purposes").

98. The general inability to amend the purposes of a charitable trust absent cy pres proceedings is longstanding. *See, e.g.*, RESTATEMENT (THIRD) OF TRUSTS § 67 cmt. a (2003).

99. As Professor Brody has observed, "a corporate charity might more easily change its purposes than a charitable trust." *See Brody*, *The Limits*, *supra* note 1, at 1418 n.76.

100. *See supra* text accompanying notes 51–52. By "substantive" approval, I mean evaluation of the merits of a change to the charter. It is not unusual for a statute to require the filing of charter amendments with a public official, whose review thereof is limited to establishing that the amendments satisfy formal legal requirements. *See, e.g.*, TEX. BUS. ORGS. CODE ANN. § 4.002(a) (West 2011) (conditioning official filing of instruments on a finding by the Secretary of State that the instrument conforms to statutory requirements).

Because of these typically liberal statutory amendment procedures, and absent specific statutory directives to the contrary, donors may assume that a charitable corporation can use gifts unaccompanied by any explicit donor-imposed restriction or explicit charity-imposed limitations[101] for any bona fide "charitable" purpose. Further, even if donors assume that a charity cannot use donations to further purposes that deviate from those articulated by its corporate charter at the time of receiving donations, it does not follow that using such donations is "unfair" to donors. One may argue that a charity acts "fairly" as long as the charity breaches no explicit promise to donors—including those made in fundraising appeals—and does not divert donations either to a non-charitable use or to a charitable use antithetical to the original purposes of the donee.[102] Moreover, it is possible that some donors, if presented the choice, would prefer that a charitable donee have the flexibility to use donations to advance the charity in the manner that the charity's board determines to be most effective, even if that requires a change of purpose or mission.[103] That this flexibility might appeal to donors of unrestricted gifts is plausible, given that such donors chose not to subject their donations to any explicit restrictions when they made their gifts,[104] and the only alternative available under the laws of many states is a costly cy pres proceeding, which many donors might rationally disfavor.[105]

101. The charitable donee itself could be deemed to have subjected donations to a restriction by assuring donors in fundraising appeals that the charity will use the donated funds for specified charitable purposes. *See* Johnny Rex Buckles, *When Charitable Gifts Soar Above Twin Towers: A Federal Income Tax Solution to the Problem of Publicly Solicited Surplus Donations Raised for a Designated Charitable Purpose*, 71 FORDHAM L. REV. 1827, 1838–39 (2003).

102. To illustrate, a charity would frustrate the reliance-based equity purpose if a religious organization formed to spread the Gospel of Jesus Christ in overwhelmingly Muslim countries amended its charter purposes to promote the global expansion of Islam and then used pre-charter-amendment donations to do so.

103. *See* Katz, *supra* note 1, at 715–16.

104. This argument assumes that donors are reasonably well-informed about the laws concerning restricted gifts and that restricting their gifts is a cost-efficient measure for these donors. In actuality, many donors may be ignorant of the law of charitable gifts to corporations and charitable gifts in trust. *See* Katz, *supra* note 1, at 716–17.

105. Although I have suggested reasons to question the reliance-based equity purpose, I concede that I still find it to have some persuasive appeal. Some of the arguments that I have advanced against it assume that donors contemplate only two possible outcomes when a charity board wants to change course—that charity fiduciaries file costly cy pres proceedings or that donors defer to the judgment of the charity's board. One can imagine other legal regimes that better serve donors' reliance interests. For example, a state could enact legislation requiring court approval of material deviations from charter purposes under a standard of review that is highly deferential to charity boards. One could also envision a regime in which charter amendments to a purposes clause require the consent of a committee consisting of representative donors and other community stakeholders, approval by a court, or the state attorney general. Other reforms that would protect the reliance interests of donors and other stakeholders are also possible.

C. Efficiency Considerations

1. Reliance-Based Efficiency

Another conceivable purpose of obedience norms is to protect the reliance interest of donors according to a notion of efficiency.[106] To endorse this purpose is to argue that those who donate to a charity desire to support particular charitable operations conducted by the charitable donee,[107] and that their willingness to do so signals that the charity's existing operations merit support. Under this view, allowing charity fiduciaries to change the nature of the charity's operations at will after the charity receives such donations will dissuade such donors, ex ante, from donating to the cause that they otherwise deem meritorious.[108] This dissuasion is inefficient because, presumably, the "market for donations" can identify efficient charitable uses. I will refer to this asserted aim of obedience norms as the "reliance-based efficiency purpose." As in the case of the reliance-based equity purpose, one who advocates this purpose of obedience norms would favor the static charter fidelity norm over the dynamic charter fidelity norm and likely embrace the historic mission fidelity norm.[109]

The reliance-based efficiency purpose is also problematic as applied to charitable corporations. First, it is unclear that those who donate to charitable corporations really assume that charity boards are prohibited from amending charter purposes and then using pre-amendment donations to advance post-amendment purposes.[110] Secondly, to favor the efficiency of charity may require one to disfavor background rules that require costly judicial proceedings every time a charity desires to amend its purposes and apply existing funds to advance those purposes. Some rational donors of unrestricted gifts may prefer a system that enables charities to adapt quickly and easily to unforeseen circumstances without incurring substantial transaction costs.[111] They may conclude, as others have concluded, that such a system is probably more efficient than the alternatives.[112] Moreover, those donors who do favor background rules requiring judicial approval of a charity's proposal to use assets to further post-amendment purposes can

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106. *See generally* Katz, *supra* note 1, at 717–18 (discussing the possible efficiencies of trust law parallelism but ultimately rejecting it in the context of unrestricted charitable gifts to corporate charities).

107. *Cf.* Gary, *supra* note 1, at 616 ("As a practical matter, to be able to attract future gifts from the same donors or from other donors, the charity must not stray far from its mission and must manage its assets effectively.").

108. *See id.*

109. *See* discussion *supra* Part III.B.

110. *See id.*

111. *See* Katz, *supra* note 1, at 715–16.

112. *See id.*

ensure that their gifts are subject to such rules.[113] Donors who desire to create and fund a new charity can create a charitable trust.[114] Similarly, donors who wish to guard against future redeployment of their gifts to a charitable corporation can explicitly restrict their donations to the current charitable purposes, or even to the current charitable mission, of the donee.[115] Such restricted charitable gifts are typically treated as (or as analogous to) charitable trusts;[116] the charity can alter the intended uses of the gift only through judicial cy pres proceedings or, under the modern Uniform Prudent Management of Institutional Funds Act, through donor consent.[117] The market for donations can thereby correct for any ill-advised rejection of the reliance-based efficiency purpose.

2. Experience-Based Efficiency

Yet another possible purpose of obedience norms is to solidify efficiencies realized over time as a charitable corporation learns how to conduct its traditional purposes better. This purpose, which I will call the "experience-based efficiency purpose," is based on the notion that, through trial and error, charities learn how best to advance their charter purposes and specific mission.[118] Casting aside historic purposes requires charities to accept a new learning curve—one that generates additional costs in the early years. One who embraces this purpose would favor the most restrictive obedience norms: static charter fidelity and historic mission fidelity.

This purpose is also of questionable merit. Robust obedience norms—such as static charter fidelity and historic mission fidelity—apply without regard to the efficiency of an entity's traditional charitable purpose. One would hope that a charity conducting the same mission for fifty years will be operating more efficiently than it did when it first began to operate, but there are reasons to doubt that it will necessarily do so. First, in early years, a charity may have more to prove to donors, and therefore, it may have a greater incentive to operate as efficiently as possible. Further, as time passes, a culture of loyalty to longstanding employees may produce inefficiencies if underproductive employees are retained and more

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113. *See* Katz, *supra* note 1, at 711 (quoting Evelyn Brody, *The Legal Framework for Restricted Gift: The Cy Pres Doctrine and Corporate Charities* 1 (draft Nov. 2003) (unpublished manuscript, on file with author)).

114. *Id.* at 715 (stating that "each grantor will find a form whose default rules fit her needs or preferences with a relatively small amount of tinkering").

115. *See* Sugin, *supra* note 1, at 914 ("Without additional legal protections, donors have tremendous power under contract law, as they define the terms of their gifts.").

116. *See* RESTATEMENT (THIRD) OF TRUSTS § 28 cmt. a (2003).

117. *See* UNIF. PRUDENT MGMT. OF INSTITUTIONAL FUNDS ACT § 6(a) (2006).

118. *Cf.* Benjamin, *supra* note 1, at 1688 (arguing that deviating from a charity's mission may "pull the organization outside its realm of expertise").

productive prospective employees are not hired. Additionally, limiting a charity board's ability to refocus the charity's mission can also perpetuate an inefficient operation as easily as it can solidify an efficient one. Indeed, one reason that a charity's board may desire a change in an entity's charitable purpose or mission is that the current mode of delivering charity has become inefficient.[119]

D. Tentative Conclusions

Tentatively, I conclude that the most compelling purpose of obedience norms is the public benefit purpose.[120] While the several norms identified above serve this purpose, I suspect that the elemental charity advancement norm generally serves this purpose as well as any other. Admittedly, one can argue that compelling charity fiduciaries to advance a specific charitable purpose magnifies the potential for public benefit because it encourages charity fiduciaries to focus and thereby gain special expertise in one or more charitable pursuits. Such an argument supports mission fidelity norms. The counter-argument is that narrowly circumscribing the purposes that charity fiduciaries can advance at any point in time impedes the ability of a charity to respond quickly to meet pressing charitable needs that fall outside of its current mission and may encourage an inefficient preoccupation with process (i.e., "mission formation") at the expense of delivering charitable goods to the greatest possible degree.

I tentatively conclude that the remaining conceivable purposes of obedience norms are less compelling, although they merit further analysis. Of these remaining purposes, the reliance-based equity purpose appears more compelling than the purposes articulated in efficiency terms—not because efficiency is unimportant, but because a preliminary assessment suggests that efficiency may be better enhanced through a system that rejects the arguments supporting reliance-based efficiency and experience-based efficiency.[121] I further suspect that for the law to serve the reliance-

119. As Professor Katz observes, many favor broad discretion by charity boards to respond to changing needs because such boards are perceived to have superior information and expertise. *See* Katz, *supra* note 1, at 715.

120. I emphasize that I reach this conclusion only as applied to charitable gifts that are not explicitly restricted for specific charitable purposes by donors. Donors who make explicitly restricted gifts probably act on assumptions that differ in part from those of donors of unrestricted gifts, and the behavior of each is likely affected by those different assumptions.

121. In assessing both reliance-based efficiency and experience-based efficiency, one should also observe that subtle efficiency losses may result from a background legal rule that requires charities to obtain judicial authorization to use assets held prior to a charter amendment to further post-amendment purposes. Given that background rule, some charities may simply opt not to pursue cy pres proceedings because of the time and money they require. Presumably, under such a background rule, a charity that refrains from going to court must advance both the new and the former charter purposes. A charity unwilling to devote newly acquired resources to perform both functions may actually choose to operate the "old" charitable program inefficiently (e.g., by employing lower-paid, lesser-skilled workers to carry

based equity purpose sensibly, significant statutory reforms are necessary.[122]

IV. THE FEDERALIZATION OF OBEDIENCE NORMS AND THEIR PURPOSES

This part discusses the degree to which federal tax law appears to embrace various obedience norms and the purposes that arguably justify them. Three features of federal tax law are examined: (1) fundamental exemption requirements (and related doctrines); (2) the federal excise tax regime governing charities and charity fiduciaries; and (3) the UBIT.

That certain of these features of federal tax law are properly understood in terms of federal obedience norms is not entirely unique to the author. Professor James Fishman, for example, has characterized certain fundamental requirements for federal income tax exemption[123] as embodying the "duty of obedience."[124] Similarly, Professor Linda Sugin has observed "[f]ederalization of obedience in the UBIT rules,"[125] and has opined that the prohibition against private inurement of the net earnings of a tax-exempt charity[126] "guarantees that the organization will be operated to achieve its mission."[127]

Understanding these and several other federal tax laws governing charities and their managers in terms of obedience norms is sensible. Because charity fiduciaries ultimately are responsible for the operations of the charities that they govern, entity-level tax rules[128] that embrace obedience norms indirectly require fiduciaries to comply with them. Moreover, many excise taxes are imposed directly on charity managers who cause a charity to engage in various transactions.[129] To the extent that these

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out the old mission of the charity, by failing to modernize the plant and equipment used to carry out the old mission, etc.). Charity fiduciaries that cause their entities to operate in this manner do not necessarily breach any fiduciary duty. Resources are limited, and charity fiduciaries may argue successfully that they in good faith have reasonably determined that the most charitable good can be accomplished by prioritizing the new charter purposes. A background rule that encourages the inefficient, protracted "fizzling out" of activities fulfilling the old charter purposes is at least of questionable value.

122. *See supra* text accompanying note 105.

123. *See infra* Part IV.A.

124. Fishman, *supra* note 1, at 238–39.

125. Sugin, *supra* note 1, at 924.

126. *See infra* Part IV.A.2.

127. Sugin, *supra* note 1, at 918 ("So what distinguishes nonprofit charity from for-profit social entrepreneurship? I believe that the distinction relates to the duty of obedience to mission . . . .").

128. Such entity-level rules include the basic requirements for obtaining and maintaining federal income tax exemption, *see infra* Part IV.A, and excise taxes imposed on charities that act (or fail to act) in certain ways. *See infra* Part IV.B.2.

129. *See, e.g.*, I.R.C. §§ 4941(a)(2) & (b)(2); 4945(a)(2) & (b)(2); 4958(a)(2); 4966(a)(2); 4967(a)(2) (2006).

excise tax provisions advance an obedience norm,[130] they quite directly require fiduciaries to comply with the norm.

A. Fundamental Exemption Requirements

Section 501(a) of the Internal Revenue Code (the "Code") exempts from federal income taxation organizations described in Code section 501(c).[131] Code section 501(c)(3) describes the following organizations:

> Corporations, and any community chest, fund, or foundation, [1] 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 (but only if no part of its activities involve the provision of athletic facilities or equipment), or for the prevention of cruelty to children or animals, [2] no part of the net earnings of which inures to the benefit of any private shareholder or individual, [3] no substantial part of the activities of which is carrying on propaganda, or otherwise attempting, to influence legislation (except as otherwise provided in subsection (h)), and [4] which does 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.[132]

The Treasury regulations interpret the first requirement[133] as setting forth both an organizational test and an operational test.[134] In addition, the regulations and case law interpret the first statutory requirement as prohibiting an organization from conferring excessive private benefit.[135] The second statutory requirement is simply known as the prohibition against private inurement of net earnings.[136] To these one may add two

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130. *See infra* Part IV.B.2.

131. I.R.C. § 501(a) (2006).

132. *Id.* § 501(c)(3) (bracketed numbers added for clarity).

133. I.e., that immediately following "[1]" in the quoted excerpt.

134. *See* Treas. Reg. § 1.501(c)(3)-1(a) (2008).

135. *See id.* § 1.501(c)(3)-1(d)(1)(ii).

136. The third and fourth requirements—the prohibition against excessive lobbying and the categorical prohibition against electioneering—can also be explained in terms of obedience norms. Certainly, both constraints are likely thought to serve the public benefit purpose. However, an organization that otherwise fulfills charter purposes meeting the common law definition of charity would not necessarily cease to be charitable merely because it engages in lobbying and electioneering as instrumental means to achieve its charitable goals. Hence, these restrictions over-inclusively enforce the negative corollary of the charity advancement norm in much the same way that numerous excise tax provisions do so. *See infra* Part IV.B.2.b. For a general discussion of the possible rationales for the ban on electioneering, see 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 (2008); 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 (2007).

judicial doctrines and one administrative doctrine that pertain to fundamental exemption requirements.[137]

1. Organizational and Operational Tests

Under the organizational test, an entity's charter must limit its purposes to one or more exempt purposes (i.e., the purposes described in Code § 501(c)(3)),[138] and generally must not expressly empower the charity to engage in activities that do not further those exempt purposes.[139] Under the operational test, an entity must engage "primarily in activities which accomplish one or more" exempt purposes.[140] An entity fails the test "if more than an insubstantial part of its activities is not in furtherance of an exempt purpose."[141] In addition to restating the statutorily-designated exempt purposes, the regulations state that the term "charitable" in section 501(c)(3) retains "its generally accepted legal sense,"[142] and is not "limited by the separate enumeration in § 501(c)(3) of other tax-exempt purposes which may fall within the broad outlines of charity as developed by judicial decisions."[143]

At a minimum, the regulations clearly embrace the charity advancement norm. Indeed, the organizational and operational tests manifestly require an entity to advance charitable goals to qualify for federal income tax exemption.[144] Interestingly, the tests fall short of expressly adopting any particular norm of charter fidelity, and they do not require mission fidelity. Although an organization must be organized "for one or more exempt purposes"[145] and must engage "primarily in activities which accomplish one or more of such exempt purposes,"[146] the regulations do not specifically require an entity to advance the exempt purposes for which it is organized. Nonetheless, the regulations appear to assume that charter purposes are legally binding; otherwise, the organizational test would be pointless. The regulations thereby require an entity to advance some charitable purpose and further assume that it will do so pursuant to its charter. The organizational and operational tests, however, lack any requirement that an entity advance its mission or that it advance only those purposes named in its charter as of the date of its incorporation (or as of any

137. *See infra* Part IV.A.3–5.

138. *See* Treas. Reg. § 1.501(c)(3)-1(b)(1)(i)(a).

139. *See id.* § 1.501(c)(3)-1(b)(1)(i)(b).

140. *Id.* § 1.501(c)(3)-1(c)(1).

141. *Id.* In addition, the organization must not operate so as to violate the other statutory requirements for qualifying under Code section 501(c)(3). *See id.* § 1.501(c)(3)-1(c)(2) to (3).

142. *Id.* § 1.501(c)(3)-1(d)(2).

143. *Id.*

144. *See* Treas. Reg. § 1.501(c)(3)-1(b)(1)(i)(a).

145. *Id.* § 1.501(c)(3)-1(b)(1)(i)(a).

146. *Id.* § 1.501(c)(3)-1(c)(1).

other date). The most logical inference is that the organizational and operational tests assume no more than the dynamic charter fidelity norm.[147]

Administrative practice confirms this conclusion. An organization that modifies its express purposes in its organizing document must notify the IRS of the change in its annual information return.[148] This requirement is consistent with the dynamic charter fidelity norm; it assumes that organizations are free to amend their express charter purposes without first obtaining the approval of the IRS—an assumption inconsistent with the static charter fidelity norm and the historic mission fidelity norm applied federally.[149] However, the reporting requirement also assumes that charter amendments have material legal significance, otherwise there would be no need to report them.[150] Again, the reporting system appears to assume that the dynamic charter fidelity norm is operative.

2. Prohibition Against Excessive Private Benefit and Any Private Inurement of Net Earnings

Two related prohibitions of federal tax law serve the public benefit purpose and promote the negative corollary of the charity advancement norm.[151] First, to satisfy the organizational and operational tests, an organization must serve a public rather than a private interest.[152] This means that the entity must "establish that it is not organized or operated for the benefit of private interests such as designated individuals, the creator or his family, shareholders of the organization, or persons controlled, directly or indirectly, by such private interests."[153] This language has spawned the "private benefit doctrine."[154]

Applying this doctrine, the United States Tax Court has held that an organization fails to qualify for income tax exemption when it benefits private interests more than insubstantially, relative to the general public

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147. One may also argue that the regulations assume the legality norm. *See infra* Part IV.A.3.

148. *See* I.R.C. § 6033 (2010) (requiring the filing of annual information returns by most exempt organizations); IRS Form 990, Part VI.A Line 4 & Instructions, *available at* http://www.irs.gov/charities/article/0,,id=233830,00.html (requiring the reporting of significant changes to articles of incorporation); IRS Form 990-PF, Part VII.A, Line 3, *available at* http://www.irs.gov/pub/irs-pdf/f990pf.pdf (requiring the filing of a copy of changes to articles and bylaws). Public charities file Form 990, and private foundations file Form 990-PF. *See* Treas. Reg. § 1.6033-2(a)(2)(i).

149. By stating that the reporting requirement rejects these norms as "applied federally," I simply mean that no federal agency or official must first approve a change in historic charter purposes or historic mission. Of course, it is also true that the IRS does not require any showing that a state public body or official has conducted a substantive review of a charter amendment prior to approving it.

150. *See* IRS Form 990-PF, *supra* note 148.

151. Treas. Reg. § 1.501(c)(3)-1(d)(1)(ii) (2008).

152. *See id.* § 1.501(c)(3)-1(d)(1)(ii).

153. *Id.*

154. *See generally* BRUCE R. HOPKINS, THE LAW OF TAX-EXEMPT ORGANIZATIONS 460–62 (7th ed. 1998) (discussing the private benefit doctrine and observing that the doctrine is distinct from—yet to some extent subsumes—the private inurement doctrine).

benefits conferred thereby.[155] Further, the IRS deems a private benefit "incidental" only if it is incidental both quantitatively and qualitatively.[156] According to the IRS, a private benefit is quantitatively incidental only if it is not substantial in view of the activity's overall public benefit.[157] A benefit is qualitatively incidental only if the benefit is a necessary concomitant of the activity benefitting the public (i.e., the only way to benefit the public is to benefit certain private individuals as well).[158]

Furthermore, an organization is not described in Code § 501(c)(3) "if its net earnings inure in whole or in part to the benefit of private shareholders or individuals."[159] This prohibition against the use of a charity's earnings for private gain is commonly identified as the private inurement doctrine, and it differs from the private benefit doctrine in at least two respects.[160] First, it applies only to a "private shareholder[] or individual[]," someone "having a personal and private interest in the activities of the organization."[161] Secondly, under the statute, the prohibition against private inurement applies when any portion of "net earnings" of a charitable organization inures to the benefit of an insider—with no de minimis exception.[162] By contrast, conferring "incidental" private benefit is tolerated under the private benefit doctrine.[163]

Like the organizational and operational tests, the private benefit doctrine and the prohibition against private inurement serve the public benefit purpose.[164] A charity fiduciary that is barred from advancing the private interests of others is more likely to continue advancing charitable purposes.[165] For the same reason, the private benefit doctrine and the private inurement doctrine implement in part the negative corollary of the

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155. *See, e.g.*, Am. Campaign Acad. v. Comm'r, 92 T.C. 1053, 1067–79 (1989) (holding that an organization that trained people for careers in political campaigning substantially benefited private interests (the Republican party and its candidates) and therefore failed to qualify as a tax-exempt educational organization).

156. *See, e.g.*, IRS Gen. Couns. Mem. 37,789 (Dec. 18, 1978).

157. *See id.*

158. *See id.*

159. Treas. Reg. § 1.501(c)(3)-1(c)(2) (2008).

160. *See generally* HOPKINS, *supra* note 154, at 427–60 (discussing the private inurement doctrine).

161. Treas. Reg. § 1.501(a)-1(c). Under case law, a person generally has a private, personal interest in the entity only if she can exert control over its operations. *Compare* United Cancer Council, Inc. v. Comm'r, 165 F.3d 1173, 1178–79 (7th Cir. 1999) (finding no private inurement when a professional fundraising firm that dominated a charitable entity could not formally control it), *with* Variety Club Tent No. 6 Charities, Inc. v. Comm'r, 74 T.C.M. (CCH) 1485, 1493 (1997) (finding that a person had the requisite private interest in a charity when he had a significant voice in its operations and formal and informal control over much of its income).

162. *See* Treas. Reg. § 1.501(c)(3)-1(c)(2).

163. *See* HOPKINS, *supra* note 154, at 427–60.

164. *See* PLNO, *supra* note 3, § 310. The requirements of these two doctrines inhere in the duty of loyalty as expressed in PLNO. *Id.* According to PLNO, § 310, the duty of loyalty requires "fiduciaries to govern for charitable purposes and" compels them not to govern "for the benefit of board members, executives, donors, or other private parties." PLNO, *supra* note 3, § 310 cmt. a(1).

165. Professor Sugin has made a similar point. *See* Sugin, *supra* note 1, at 918.

charity advancement norm. To run afoul of these doctrines is to operate in a "non-charitable" manner.

3. The Public Policy Doctrine

A doctrine grounded in case law and administrative practice also embraces the legality norm, albeit in an expansive form. In *Bob Jones University v. United States*,[166] the United States Supreme Court held that an organization claiming federal income tax exemption by virtue of Code § 501(c)(3) must not have a purpose that is illegal or that violates "established public policy."[167] The Court reasoned that an organization is described in Code § 501(c)(3) only if it satisfies common law concepts of charity.[168] The Court purported to construe Code § 501(c)(3) within the statute's "framework . . . and against the background of the congressional purposes."[169] Noting parallels between Code §§ 501(c)(3) and 170(c)[170] and observing that section 170 authorizes a deduction for "charitable contributions," the Court in *Bob Jones* found that Congress sought to confer tax benefits on organizations serving charitable purposes.[171] According to the Court, Congress desired to promote "charitable" organizations because they serve a salutary public purpose.[172] Consistent with the common law, the Court concluded that "an institution seeking tax-exempt status must serve a public purpose and not be contrary to established public policy."[173]

The public policy doctrine incorporates an enhanced version of the legality norm into Code § 501(c)(3). Under the doctrine, law and "established public policy" apparently reflected by law circumscribe the universe of "charitable" organizations described in Code section 501(c)(3).[174] To breach established public policy is to violate the federal norm that *Bob Jones* imposes on all § 501(c)(3) entities.[175] Although the precise scope of this federal supra-legality norm is quite uncertain, the

166. Bob Jones Univ. v. United States, 461 U.S. 574 (1983).

167. *Id.* at 591, 595–96 (holding that two schools maintaining racially discriminatory policies as to students violated established public policy).

168. *See id.* at 586, 588–89.

169. *Id.* at 586.

170. Code section 170(a)(1) authorizes a deduction for a "charitable contribution," which is defined in Code section 170(c). I.R.C. § 170(c) (2006). Under section 170(c)(2), a "charitable contribution" includes a gift to "[a] corporation, trust, or community chest, fund, or foundation" that satisfies certain requirements. *Id.* § 170(c)(2). Such requirements include those set forth in Code section 501(c)(3). *See id.* § 170(c)(2)(A)–(D).

171. *Bob Jones*, 461 U.S. at 586–88.

172. *See id.* at 587–88 ("Congress sought to provide tax benefits to charitable organizations, to encourage the development of private institutions that serve a useful public purpose or supplement or take the place of public institutions of the same kind.").

173. *Id.* at 586.

174. *Id.*

175. *See id.* at 586–87.

existence of the norm is indisputable (at least until the Supreme Court revisits *Bob Jones*).[176]

4. The Commerciality Doctrine

The Treasury regulations limit the degree to which a charity may operate for commercial purposes:

> An organization may meet the requirements of section 501(c)(3) although it operates a trade or business as a substantial part of its activities, if the operation of such trade or business is in furtherance of the organization's exempt purpose or purposes and if the organization is not organized or operated for the primary purpose of carrying on an unrelated trade or business, as defined in section 513. In determining the existence or nonexistence of such primary purpose, all the circumstances must be considered, including the size and extent of the trade or business and the size and extent of the activities which are in furtherance of one or more exempt purposes. An organization which is organized and operated for the primary purpose of carrying on an unrelated trade or business is not exempt under section 501(c)(3) . . . .[177]

The so-called "commerciality doctrine" emerged from the regulations in a variety of cases.[178] According to one representative case, *Scripture Press Foundation v. United States*,[179] when an entity claims exemption on the basis of furthering an exempt purpose through a commercial activity, "what is dispositive is whether the business activities of the taxpayer are incidental to its charitable objectives or whether, in fact, the converse is true."[180] In this case, the court found that the entity failed the test of exemption because its revenue from sales of religious literature far exceeded its expenditures on religious training and produced large accumulated earnings.[181] However, no fact is controlling in isolation. In *Presbyterian & Reformed Publishing Company v. Commissioner*,[182] the United States Court of Appeals for the Third Circuit rejected the view that accumulating profits from the sale of religious literature necessarily implies

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176. For extensive discussions of the uncertain scope of the public policy doctrine, see 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 (2009); Johnny Rex Buckles, *Reforming the Public Policy Doctrine*, 53 U. KAN. L. REV. 397 (2005).

177. Treas. Reg. § 1.501(c)(3)-1(e)(1) (2008).

178. *See, e.g.*, Scripture Press Found. v. United States, 285 F.2d 800, 803 (Ct. Cl. 1961), *cert. denied*, 368 U.S. 985 (1962); Presbyterian & Reformed Publ'g Co. v. Comm'r, 743 F.2d 148, 151–58 (3d. Cir. 1984).

179. *Scripture Press Found.*, 285 F.2d 800.

180. *Id.* at 805.

181. *See id.* at 805–07.

182. *Presbyterian & Reformed Publ'g Co.*, 743 F.2d 148.

that the organization lacks a primary exempt purpose.[183] In this case, although the court approvingly cited the Tax Court for the proposition that "courts have focused on the manner in which activities themselves are carried on, implicitly reasoning that an end can be inferred from the chosen means," the appellate court insisted that "the inquiry must remain that of determining the purpose to which the increased business activity is directed."[184]

The determination of primary purpose that the commerciality doctrine requires is admittedly imprecise and otherwise troublesome.[185] But let us table a critique of the commerciality doctrine and focus on its current relevance. The doctrine corresponds closely to the charity advancement norm.[186] The commerciality doctrine assumes that a court is capable of discerning the true purpose of an entity—a purpose that may diverge from the entity's stated charter purposes and stated mission.[187] Further, the doctrine requires that such actual purpose conform to one that the law recognizes as charitable.[188] Insofar as the charity advancement norm requires charity fiduciaries to act so as to advance charitable purposes, it largely imposes a fiduciary mandate that parallels the mandate on charitable entities imposed by the commerciality doctrine.

5. The Commensurate in Scope Doctrine

Professor Sugin has opined that obedience norms may inform the "commensurate in scope" doctrine,[189] an administrative doctrine which itself has an imprecise "scope."[190] The doctrine emerges from a succinct Revenue Ruling, the relevant portion of which states as follows:

> A corporation organized exclusively for charitable purposes derives its income principally from the rental of space in a large commercial office building which it owns, maintains and operates. The charitable purposes of the corporation are carried out by aiding other charitable organizations, selected in the discretion of its governing body, through contributions and grants to such organizations for charitable purposes. *Held*, the corporation is deemed to meet the primary purpose test of section 1.501(c)(3)-1(e)(1)

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183. *See id.* at 154–58.

184. *Id.* at 155, 156.

185. *Cf. id.* ("Despite the long history of § 501(c)(3) and the numerous organizations that have claimed its coverage, no regulation or body of case law has defined the concept of 'purpose' under this provision . . . with sufficient clarity to protect against arbitrary, ad hoc decision-making."). *See also* John D. Columbo, *Why is Harvard Tax-Exempt? (And Other Mysteries of Tax Exemption for Private Educational Institutions)*, 35 ARIZ. L. REV. 841, 848–50 (1993).

186. *See supra* Part II.B.

187. *See supra* notes 180–84 and accompanying text.

188. *See supra* notes 180–84 and accompanying text.

189. *See* Sugin, *supra* note 1, at 921–22.

190. *See id.*

> of the Income Tax Regulations, and to be entitled to exemption from Federal income tax as a corporation organized and operated exclusively for charitable purposes within the meaning of section 501(c)(3) of the Internal Revenue Code of 1954, where it is shown to be carrying on through such contributions and grants a charitable program commensurate in scope with its financial resources.[191]

The precise contexts in which the commensurate in scope doctrine should be applied are debatable. Revenue Ruling 64-182, which announces the doctrine, appears to relate it to the specific provision of the Treasury regulations upon which the commerciality doctrine is based.[192] Under the revenue ruling, the commensurate in scope doctrine is a tool for determining whether an entity has a primarily charitable purpose or instead a primarily commercial purpose.[193] Others have expressed interest in expanding the doctrine to require more broadly that charities actually conduct charitable activities in scope with their resources.[194] Under either approach, one can discern that the doctrine attempts to ensure adherence to the charity advancement norm, insofar as it reinforces fidelity to "charitable goals."[195]

B. Federal Excise Tax Provisions

The federal excise tax regime is an extremely complex morass of rules governing multiple types of charitable entities and a variety of activities and transactions in which they do or might engage. Notwithstanding the variety of these rules and the myriad contexts in which they apply, one general theme emerges from an examination of the law: The federal excise tax regime is an (imperfect) attempt to ensure that charity fiduciaries adhere to the charity advancement norm and its negative corollary. The federal excise tax regime also appears to assume the existence of the dynamic charter fidelity norm in the case of one type of charitable entity.[196]

To demonstrate the thesis that the federal excise tax regime elevates the charity advancement norm above all others, it is first necessary to survey the basic classification scheme of charities under the Code. After providing the necessary survey, this article then discusses the excise tax rules that directly promote the charity advancement norm or its negative corollary, and the excise tax rules that are apparently designed to ensure

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191. Rev. Rul. 64-182, 1964-1 C.B. 186.
192. Treas. Reg. § 1.501(c)(3)-1(e)(1) (2008).
193. *See* Rev. Rul. 64-182, 1964-1 C.B. 186.
194. *See* Sugin, *supra* note 1, at 921–22 (discussing a letter from Senate Finance Committee Members Max Baucus and Charles Grassley to the Secretary of the Treasury).
195. Sugin, *supra* note 1, at 921.
196. *See* I.R.C. § 508(e)(1) (2006).

adherence to the negative corollary of the charity advancement norm, but do so over-inclusively.

1. Classification of Charitable Entities

Code § 509 classifies charitable entities according to their sources of support, their affiliation with other charitable organizations, and (to a limited degree) the nature of their operations.[197] A charity that is not described in one of the subsections of Code § 509(a) is classified as a private foundation.[198] The following discussion describes succinctly the major types of charities.[199]

a. Unaffiliated Public Charities

A tax-exempt charity described in Code § 509(a)(1) or § 509(a)(2) is accurately described as an "unaffiliated public charity."[200] These organizations first include traditional public charities—churches, primary and secondary schools, colleges, universities, hospitals, and certain medical research organizations affiliated with hospitals.[201] These entities derive their non-private foundation status on account of their operations, rather than their sources of funding.[202]

Other entities qualify as unaffiliated public charities in virtue of their sources of funding. One type includes any organization that normally receives a substantial portion of its total support—exclusive of income received in performing its tax-exempt function—from a governmental unit or from direct or indirect contributions from a broad segment of the general public.[203] Another type includes any charity that does not normally receive

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197. I.R.C. § 509(a) (2006).

198. *See id.* (opening sentence).

199. The classification system and discussion appearing in Part IV.B.1 is substantially similar to that set forth in three prior articles. *See, e.g.*, Johnny Rex Buckles, *The Federalization of the Duty of Loyalty Governing Charity Fiduciaries Under United States Tax Law*, 99 KY. L.J. 645, 662–64 (2011) [hereinafter Buckles, *Duty of Loyalty*]; Johnny Rex Buckles, *Fiduciary Assumptions Underlying the Federal Excise Taxation of Compensation Paid by Charities*, 45 REAL PROP. TR. & EST. L.J. 53, 58–62 (2010) [hereinafter Buckles, *Fiduciary Assumptions*]; 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, 498–503 (2010) [hereinafter Buckles, *Private Foundation Substitutes*].

200. An entity described in paragraph (1) or (2) of Code section 509(a) may have a formal affiliation with another charity. However, any such affiliation is not essential to the entity's classification as other than a private foundation. *See generally* I.R.C. § 509(a). Hence, the term "unaffiliated public charity" in this article refers to any organization described in Code section 509(a)(1) or (2), regardless of its relationship to another charity.

201. *See* I.R.C. §§ 170(b)(1)(A)(i)–(iii); 509(a)(1) (2006).

202. *See id.*

203. I.R.C. §§ 170(b)(1)(A)(vi); 509(a)(1); Treas. Reg. §1.170A-9(e) (as amended 2008) (setting forth two alternative tests for qualifying as a publicly supported organization).

more than one-third of its total support from unrelated business activities and investments, and normally receives more than one-third of its total support from any combination of gifts, grants, membership fees, and income from performing an exempt function.[204]

b. Supporting Organizations

Another type of charity classified as other than a private foundation is a supporting organization (SO).[205] An SO maintains a structural relationship with another charity that one may liken to a subsidiary/parent or brother/sister relationship between for-profit corporations.[206] An SO must satisfy three requirements.[207] First, the SO must be organized and operated solely "for the benefit of, to perform the functions of, or to carry out the purposes of " § 509(a)(1) or § 509(a)(2) entity (hereinafter referred to as a "supported organization").[208] Second, the SO must satisfy one of three alternative statutory requirements ensuring that the supported organization controls the SO, or that the two entities share common supervision or complementary operations.[209] These requirements underpin the classification of an SO as a "Type I," "Type II," or "Type III" SO.[210] Finally, designated insiders, including large donors and their family members, must not control the SO.[211]

c. Private Foundations

A tax-exempt entity described in Code § 501(c)(3) that is neither an SO nor an unaffiliated public charity is classified as a private foundation.[212] Typically, a single large donor or small group of donors (such as an individual, couple, family, or corporation) primarily or exclusively funds a private foundation.[213]

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204. *See* I.R.C. § 509(a)(2). For these purposes, qualifying support does not include receipts from certain insiders of the charity or from non-publicly supported charities. *See id.* § 509(a)(2)(A).

205. *See* I.R.C. § 509(a)(3); Treas. Reg. § 1.509(a)-4(g)(1)(i) (as amended in 1981).

206. *See* Treas. Reg. § 1.509(a)-4(g)(1)(i); STAFF OF JOINT COMM. ON TAXATION, 109th CONG., TECHNICAL EXPLANATION OF H.R. 4 331–32 (Comm. Print 2006).

207. *See* I.R.C. § 509(a)(3).

208. I.R.C. § 509(a)(3)(A).

209. *See* I.R.C. § 509(a)(3)(B); Treas. Reg. § 1.509(a)-4(f)(2)(i)–(ii).

210. *See* Treas. Reg. § 1.509(a)-4(f)(2)(i)–(ii).

211. *See* I.R.C. §§ 509(a)(3)(C), 4946 (2006).

212. *See* I.R.C. § 509(a).

213. *See* STAFF OF JOINT COMM. ON TAXATION, 109TH CONG., TECHNICAL EXPLANATION OF H.R. 4 335 (Comm. Print 2006).

d. Donor Advised Funds

A donor advised fund (DAF) is actually a component of a charity, rather than a distinct legal person.[214] However, transactions involving a DAF are subject to special excise tax rules that functionally require analysis of a DAF as though it were a charitable entity for some purposes of law.[215] Subject to narrow exceptions,[216] a DAF is a fund or account that meets the following four requirements.[217] First, the charity that sponsors the fund must separately identify it "by reference to contributions of a donor or donors."[218] Second, the sponsoring charity must own and control the fund.[219] Third, by reason of her status as a donor, the donor of the fund, or her designee, must have advisory privileges with respect to the distribution or investment of fund assets.[220] Finally, the charity sponsoring the DAF must not be a private foundation.[221]

2. Federal Excise Taxes and the Charity Advancement Norm

In this section, I first discuss excise tax rules that directly and obviously promote the charity advancement norm or its negative corollary. I then identify excise tax rules that are apparently designed to ensure adherence to the negative corollary of the charity advancement norm, but do so over-inclusively, and I explain why this is so.

a. Direct Promotion of the Charity Advancement Norm and Its Negative Corollary

Code § 4942, applicable to private foundations, directly promotes the charity advancement norm.[222] This section generally imposes an excise tax on a private foundation's failure to distribute 5% of the net fair market value of its investment assets to accomplish purposes described in Code

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214. I.R.C. § 4966(d)(2)(A) (2006).

215. *See, e.g.,* I.R.C. §§ 4966, 4967(2006).

216. *See* I.R.C. § 4966(d)(2)(B)(i)–(ii) (exempting from the definition of a DAF those funds that distribute money only to a single entity and those from which money may be distributed only for certain education-related grants upon the recommendation of a committee appointed by the sponsoring organization).

217. *See* I.R.C. § 4966(d)(1)(B), (d)(2)(A).

218. I.R.C. § 4966(d)(2)(A)(i).

219. *See* I.R.C. § 4966(d)(2)(A)(ii).

220. *See* I.R.C. § 4966(d)(2)(A)(iii).

221. *See* I.R.C. § 4966(d)(1)(B) (defining "sponsoring organization" to exclude a private foundation). The definitional requirements of a DAF do not imply that a private foundation is prohibited from soliciting funds and holding them in separate accounts. Rather, any such account would simply not meet the definition of a DAF.

222. *See generally* I.R.C. § 4942 (2006).

§ 170(c)(2)(B) (i.e., charitable purposes).[223] Similarly, section 1241(d) of the Pension Protection Act of 2006[224] requires the Department of the Treasury to publish regulations on the payout required of Type III SOs that are not functionally integrated[225] with their supported organizations. The IRS has recently published proposed regulations implementing this congressional mandate.[226] In general, the proposed regulations require this type of SO to distribute on or before the last day of each taxable year amounts equaling or exceeding 5% of the aggregate fair market value of its non-exempt-use assets to or for the use of one or more supported organizations.[227]

The mandatory payout rules imposed on private foundations and certain SOs are intended to promote the charity advancement norm by requiring these entities to devote annually a specified fraction of their assets to accomplish charitable purposes.[228] The congressional concern must be that, in the absence of a quantifiable legal payout requirement, some grant-making charities might become "grant-withholding" entities that fail to accomplish charitable purposes meaningfully.[229] Interestingly, unaffiliated public charities are not subject to a payout rule.[230]

Further, Type I and Type II SOs—both of which are controlled or managed by or with unaffiliated public charities—are not subject to a

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223. *See* I.R.C. § 4942(a), (c)–(e). Technically, the tax is imposed on "undistributed income" for any taxable year, which has not been distributed before the first day of the second (or any succeeding) taxable year following the taxable year in question. *See* I.R.C. § 4942(a). "Undistributed income" means the excess of the foundation's "distributable amount" over its "qualifying distributions" for the relevant year. *See* I.R.C. § 4942(c)(1)–(2). These terms, in turn, are statutorily defined so as to produce the rule described in the text accompanying this note.

224. Pension Protection Act of 2006 § 1241(d), 29 U.S.C. § 1001 (2006).

225. Generally, an SO meets the integral part test as a functionally integrated Type III SO if it engages in certain activities that would normally be engaged in by the SO's supported organization(s) but for the SO's involvement. *See* Prop. Treas. Reg. § 1.509(a)-4(i)(3)(ii), 72 Fed. Reg. 42335-01, 42336 (Aug. 2, 2007). Substantially all of these activities in which the SO engages must directly further the exempt purposes of the supported organization(s) for which the SO is responsive by virtue of the SO's performing the functions of such supported organization(s), or by virtue of the SO's carrying out the purposes of such supported organization(s). *See id.* Activities that directly further the exempt purposes of the supported organization include holding title to exempt-use property and managing exempt-use property, but generally do not include fundraising, investing and managing non-exempt-use property, and making grants (whether to the supported organization or to third parties). *See id.*

226. *See* Payout Requirements for Supporting Organizations That Are Not Functionally Integrated, 74 Fed. Reg. 48672 (proposed Sept. 24, 2009).

227. *See id.* at 48674.

228. *See generally id.* at 48677 (discussing new regulations and how they relate to the government's need to insure that these organizations fulfill their charitable purpose).

229. *See generally id.* at 48674 (discussing the necessity of maintaining responsiveness throughout the grant-making process).

230. No excise tax on the failure to distribute income for charitable purposes applies to DAFs or their sponsoring organizations. However, the PPA requires the Secretary of the Treasury to study various issues associated with the operation of DAFs, including whether a DAF should be required to distribute, for charitable purposes, a specified portion of its income or assets. *See* Pension Protection Act 2006 § 1226(a)(2), 26 U.S.C. § 1000 (2006).

payout rule.[231] Thus, grant-making charities that appear to concern lawmakers the most are those that are not dependent on the general public for donations and those that are not controlled or managed closely by or with charities that are accountable to donors or other stakeholders likely to monitor the charity.

Several excise tax rules also directly promote the negative corollary of the charity advancement norm. The two most obvious rules govern private foundations and DAFs.[232] First, the Code section 4945 excise tax on "taxable expenditures" applies to any amount paid or incurred "for any purpose other than one specified in § 170(c)(2)(B)" (i.e., for any purposes that is not charitable).[233] Similarly, Code section 4966 imposes an excise tax on "taxable distributions" made by a DAF. A taxable distribution includes a distribution from a DAF for any purpose other than one specified in § 170(c)(2)(B) (i.e., a charitable purpose).[234] The taxes apply both to the entities[235] and their fiduciaries.[236] Insofar as these taxes discourage those who control private foundations and DAFs from using resources to further any non-charitable goal, the taxes plainly and directly enforce the negative corollary of the charity advancement norm.

Other excise tax rules, namely, those imposing a market-value standard on conflicts-of-interest transactions between a charitable entity and various "insiders" of the charity, also partially advance the negative corollary of the charity advancement norm. As explained previously, the private benefit doctrine and the private inurement doctrine implement in part the negative corollary of the charity advancement norm.[237] By prohibiting a charity from significantly serving private interests, these doctrines bar charities from engaging in certain types of "non-charitable" behavior.[238] The same may be said of excise tax provisions that discourage charities from engaging in transactions with insiders that confer unfair benefits on the insiders.[239]

The most obvious example of such a provision is the general rule of the excess benefit transactions excise tax (EBTET) imposed by Code § 4958. Code § 4958, which applies to charities other than private foundations, imposes a tax on each "excess benefit transaction."[240] Such a transaction is one "in which an economic benefit is provided by an

231. *See* Pension Protection Act of 2006 § 1241(d), 29 U.S.C. § 1001 (2006) (subjecting only certain Type III SOs to the payout rule).
232. *See generally* I.R.C. §§ 4945, 4966 (2006).
233. I.R.C. § 4945(d)(5).
234. *See* I.R.C. § 4966(c)(1)(B)(i).
235. *See* I.R.C. §§ 4945(a)(1), (b)(1); 4966(a)(1).
236. *See* I.R.C. §§ 4945(a)(2), (b)(2); 4966(a)(2).
237. *See supra* Part IV.A.2.
238. *See id.*
239. *See generally* I.R.C. § 4958 (2006).
240. *See* I.R.C. § 4958(a)(1)–(2), (b).

applicable tax-exempt organization[241] directly or indirectly to or for the use of any disqualified person[242] if the value of the economic benefit provided exceeds the value of the consideration (including the performance of services) received for providing such benefit."[243] By taxing the amount of an excess benefit[244] conferred on disqualified persons, Code § 4958 discourages the diversion of charitable assets into private hands.

There is also a special excise tax rule applicable to the payment of compensation by private foundations that accomplishes a similar objective. Most transactions between a private foundation and a "disqualified person"[245] with respect to the foundation (e.g., fiduciaries of the foundation, its large donors, and their family members) are effectively prohibited by a federal self-dealing excise tax, which is more restrictive than the EBTET.[246] However, a private foundation's payment to a disqualified person of non-excessive compensation for personal services, which are reasonable and necessary to carry out the foundation's exempt purposes, is not taxable.[247] The category of "personal services" is defined as services of a "professional and managerial" nature.[248] By effectively taxing only excessive compensation paid to disqualified persons providing personal services, this special rule functions similarly to the EBTET regime governing most charities; it partially advances the negative corollary of the charity advancement norm by prohibiting the diversion of foundation assets into private hands.

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241. An applicable tax-exempt organization is essentially any tax-exempt organization otherwise described in Code section 501(c)(3), (4), or (29), other than a private foundation. *See* I.R.C. § 4958(e)(1)–(2).

242. Although special rules apply in the case of DAFs and SOs, in general, a disqualified person is one "who was, at any time during the 5-year period ending on the date of the transaction, in a position to exercise substantial influence over the affairs of the organization." I.R.C. § 4958(f)(1)(A). A disqualified person also includes members of the family of the one with substantial influence, *see* I.R.C. § 4958(f)(1)(B), (f)(4), and business entities in which the foregoing have significant ownership or control. *See* I.R.C. § 4958(f)(1)(C), (f)(3).

243. I.R.C. § 4958(c)(1)(A).

244. *See* I.R.C. § 4958(a)(1).

245. A disqualified person includes an officer or director of the private foundation, *see* I.R.C. § 4946(a)(1)(B)–(b)(1), any substantial contributor to the foundation, *see* § 4946(a)(1)(A), a member of the family of the foregoing, *see* § 4946(a)(1)(D), and entities in which any of the foregoing hold an ownership interest exceeding 35%, *see* § 4946(a)(1)(E)–(G). A disqualified person also includes those whose ownership interest in a substantial contributor exceeds 20%, *see* § 4946(a)(1)(C), and a member of the family of any such owner, s*ee* § 4946(a)(1)(D). A "substantial contributor" to a private foundation is, in general, someone who has given more than $5,000 to the foundation, if her cumulative gifts exceed 2% of total gifts received by the foundation through the close of the year in which the contributor has made gifts to the foundation. *See* I.R.C. §§ 507(d)(2)(A), 4946(a)(2) (2006).

246. *See* I.R.C. § 4941(a)(1)–(2), (b)(1)–(2) (2006).

247. *See* I.R.C. § 4941(d)(2)(E).

248. Madden v. Comm'r, 74 T.C.M. (CCH) 440, 449 (1997). *See also* Rev. Rul. 74-591, 1974-2 C.B. 385 (ruling that the payment of a pension to a disqualified person was not an act of self-dealing when his personal services consisted of general administration, bookkeeping, investment counseling, disbursing funds, and managing real estate).

b. Over-Inclusive Promotion of the Negative Corollary of the Charity Advancement Norm

Perhaps more striking is the trend of the federal excise tax regime to promote the negative corollary of the charity advancement norm over-inclusively. In this section, I describe what I mean by an "over-inclusive" promotion of the negative corollary of the charity advancement norm, selectively illustrate the phenomenon, and identify most of these over-inclusive rules.

The negative corollary of the charity advancement norm is simply that charity fiduciaries must not act so as to advance a non-charitable purpose. A federal tax rule that effectively prohibits fiduciaries from causing their charities to engage in activities that can be inconsistent with advancing a charitable purpose, but are not necessarily inconsistent with doing so, falls within the class of "over-inclusive" rules that embrace the negative corollary of the charity advancement norm.

Several rules governing conflict of interest transactions fall within this category. For example, consider the sale of stock by a director of a private foundation to the private foundation itself. Such a transaction is a taxable act of self-dealing, even if the sale is at or below fair market value.[249] The excise tax provision effectively prohibiting sales of assets between a private foundation and a disqualified person certainly prevents sales that exploit the foundation, but also forecloses those that would benefit the foundation in carrying out its mission. Congress apparently concluded that, because of the potential for exploitation of a private foundation, an over-inclusive rule is justified.

These over-inclusive rules are not limited to conflict of interest transactions. For example, consider the private foundation excise tax on expenditures to influence legislation.[250] The fact that modest attempts to influence legislation are not inherently inconsistent with advancing a charitable mission is implicit in the requirements for obtaining and maintaining a charitable organization's federal income tax exemption. Code § 501(c)(3) permits lobbying that is not a "substantial part" of the organization's activities.[251] However, because of perceived abuses of the political process, Congress has foreclosed private foundations from influencing legislation except in highly circumscribed contexts.[252] The effective prohibition against engaging in most forms of lobbying does help

249. *See* I.R.C. § 4941(d)(1)(A).

250. *See* I.R.C. § 4945(a)(1)–(2), (b)(1)–(2), (d)(1), (e)(1)–(2) (2006).

251. *See* I.R.C. § 501(c)(3) (2006). Certainly, a theoretical case exists that even significant legislative activities can sometimes accomplish charitable purposes. Under that view, the limitation on legislative activities set forth in Code section 501(c)(3) itself over-inclusively enforces the negative corollary of the charity advancement norm.

252. *See* I.R.C. § 4945(e) (last sentence).

deter private foundations from furthering non-charitable purposes; however, the prohibition also prevents private foundations from modestly engaging in some attempts to influence legislation that would probably help them further charitable purposes.

As an additional illustration, consider the excise tax imposed on a distribution from a DAF to any natural person.[253] Certainly, prohibiting distributions to individuals reduces the risk that a DAF will be exploited to benefit friends and acquaintances of DAF insiders[254] while serving no charitable goals. However, the rule also prohibits a perfectly charitable act—aiding an individual who is a member of a charitable class, such as a homeless person or a poor patient needing expensive medical care.[255] The excise tax rule prohibits charitable and non-charitable assistance alike in the case of transfers to individuals.

There are many excise tax provisions that appear to enforce the negative corollary of the charity advancement norm, but do so over-inclusively. Some are grossly over-inclusive, whereas others probably prohibit only a small degree of activity that could further a charitable purpose. Rather than discussing the degree of "over-inclusiveness" of each provision, this article simply identifies the provisions that can probably be described fairly as over-inclusively enforcing the negative corollary of the charity advancement norm:[256]

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253. *See* I.R.C. § 4966(a), (c)(1)(A) (2006).

254. A "DAF insider" is the term that I use to refer to a donor-advisor of a DAF and certain related persons specified by statute. DAF insiders include (1) any fund donor who has advisory privileges with respect to fund distributions or investments by virtue of her status as a donor; (2) the designee of any such donor; (3) a member of the family of any such donor or designee; and (4) any business entity in which the ownership interest of the foregoing exceeds 35%. *See* I.R.C. §§ 4958(f)(7)(A)–(C), 4966(d)(2)(A)(iii) (2006).

255. Notwithstanding the general rule, a special provision makes grants to an individual from a de facto DAF possible. Section 4966(d)(2)(B)(ii) excepts from the technical definition of a DAF a fund, with respect to which a fund donor offers advice, if the following conditions are satisfied:

> (1) Individual grantees receive grants only "for travel, study, or other similar purposes";
>
> (2) The fund donor's advisory privileges are performed exclusively by her in her "capacity as a member of a committee[,] all of the members of which are appointed by the sponsoring organization";
>
> (3) No combination of the fund's donors, their designees, and related persons directly or indirectly control the committee; and
>
> (4) All grants from the fund "are awarded on an objective and nondiscriminatory basis pursuant to a procedure approved in advance by the board of directors of the sponsoring organization, and such procedure is designed to ensure that all such grants meet the requirements of paragraph (1), (2), or (3) of section 4945(g)."

See I.R.C. § 4966(d)(2)(B)(ii).

256. I have omitted a discussion of excise taxes imposed on entities that intervene in political campaigns. *See, e.g.*, I.R.C. § 4945(a)–(b), (d)(2); § 4955 (2006). One may argue that these provisions are also over-inclusive, just as Code section 501(c)(3)'s prohibition of political campaign intervention is itself an over-inclusive enforcement of the negative corollary of the charity advancement norm. The policy considerations informing a discussion of the ban on electioneering by charities are beyond the scope of this paper. For those interested in my thoughts on the subject, I refer them to the sources cited in note 136.

1. The self-dealing excise tax generally imposed on transactions between private foundations and disqualified persons (other than non-excessive compensation paid for personal services);[257]

2. The special rule under the EBTET that taxes "any grant, loan, compensation, or other similar payment" provided by an SO to a "substantial contributor"[258] or to certain persons or entities related to a substantial contributor;[259]

3. A similar rule under the EBTET that taxes "any grant, loan, compensation, or other similar payment" provided by the DAF to a DAF insider;[260]

4. The special rule under the EBTET that taxes any loan provided by an SO to a disqualified person (unless, in general, the disqualified person is a publicly supported charity);[261]

5. The tax imposed by Code section 4967, which applies if, upon the advice of a DAF insider, a distribution from the DAF is made so as to result in any DAF insider receiving a more than incidental benefit as a result of the distribution;[262]

6. The excise tax on a distribution from a DAF to any natural person,[263] and the excise tax on a grant from a private foundation to an individual "for travel, study, or other similar purposes"[264] unless certain requirements are satisfied;[265]

7. The excise tax on excess business holdings imposed on private foundations,[266] certain SOs,[267] and DAFs;[268]

I have also omitted a discussion of the section 4944 private foundation excise tax on investments that jeopardize the carrying out of exempt purposes. My reason for not including this tax in this discussion is that, although an investment is later found to be inappropriate on account of its excessive riskiness in the overall portfolio of the charity, it is not clear that the decision to make the investment implies that fiduciaries sought to act in a way that did not advance a charitable goal.

257. *See generally* I.R.C. § 4941(d)(1).

258. Substantial contributors are generally defined as individuals who have given more than $5,000 to the organization if their cumulative gifts exceed 2% of total gifts received by the organization through the close of the year in which the individuals in question have made gifts to the organization. *See* § 4958(c)(3)(C)(i).

259. *See* I.R.C. § 4958(c)(3)(A)(i)(I), (B)(i)–(iii). Somewhat simplified, the related persons include members of the substantial contributor's family as well as business entities in which the substantial contributor's ownership interest exceeds 35%. *See id.* § 4958(c)(3)(B)(ii)–(iii). For purposes of the EBTET, the entire amount of the compensation is treated as an excess benefit. *See id.* § 4958(c)(3)(A)(ii).

260. I.R.C. § 4958(c)(2)(A). For purposes of the EBTET, the entire amount of the compensation is treated as an excess benefit. *See id.* § 4958(c)(2)(B).

261. *See* I.R.C. § 4958(c)(3)(A)(i)(II). The entire amount of the loan is treated as an excess benefit. *See id.* § 4958(c)(3)(A)(ii).

262. *See* I.R.C. § 4967(a)(1) (2006).

263. *See* I.R.C. § 4966(c)(1)(A) (2006).

264. I.R.C. § 4945(d)(3) (2006).

265. *See* I.R.C. § 4945(g).

266. *See* I.R.C. § 4943(a)(1) (2006).

267. *See* I.R.C. § 4943(f)(3)(A)–(B).

268. *See* I.R.C. § 4943(e)(1).

8. The excise tax imposed on private foundations[269] and DAFs[270] if expenditure responsibility is not exercised with respect to grants to certain types of organizations; and
9. The excise tax imposed on private foundations for most attempts to influence legislation.[271]

3. Federal Excise Taxes and the Dynamic Charter Fidelity Norm

To a limited degree, the Code assumes the existence of the dynamic charter fidelity norm. Under Code § 508(e)(1), a private foundation is not exempt from federal income tax unless its governing instrument requires the foundation's income "to be distributed at such time and in such manner as not to subject the foundation to tax under section 4942."[272] Further, the governing instrument must:

> prohibit the foundation from engaging in any act of self-dealing (as defined in section 4941(d)), from retaining any excess business holdings (as defined in section 4943(c)), from making any investments in such manner as to subject the foundation to tax under section 4944, and from making any taxable expenditures (as defined in section 4945(d)).[273]

As in the case of the organizational test governing all charities, it is probable that Code § 508 assumes that charter provisions are legally binding on private foundations. Otherwise, Code § 508 seems rather pointless.[274] Further, just as the organizational test assumes that an entity will advance some charitable purpose pursuant to its charter, so does Code section 508 appear to assume that private foundation fiduciaries will be more inclined to comply with the charity advancement norm and its negative corollary—as embodied in the private foundation excise tax rules—when an entity's charter incorporates these rules. Hence, Code § 508 appears to assume some form of charter fidelity as a governing norm.

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269. *See* I.R.C. § 4945(a)–(b), (d)(4)(B). Generally, expenditure responsibility means that the private foundation exerts "all reasonable efforts . . . to establish adequate procedures (1) to see that the grant is spent solely for the purpose for which made, (2) to obtain full and complete reports from the grantee on how the funds are spent, and (3) to make full and detailed reports with respect to such expenditures to the Secretary." I.R.C. § 4945(h)(1)–(3).

270. *See* I.R.C. § 4966(a), (c)(1)(B)(ii) (2006).

271. *See* I.R.C. § 4945(a)–(b), (d)(1), (e). One could also argue that excise taxes imposed on public charities for engaging in excessive lobbying, *see, e.g.*, I.R.C. §§ 4911, 4912 (2006), over-inclusively enforce the negative corollary of the charity advancement norm.

272. I.R.C. § 508(e)(1)(A) (2006).

273. I.R.C. § 508(e)(1)(B).

274. One could argue that Code section 508 assumes only that a private foundation's charter tends to educate charity fiduciaries as to what the foundation should and should not be doing. But, such an argument does not negate the textual point. Although the charter does serve an educational function, it is quite likely that fiduciaries understand that, once they are educated by the charter, they must also obey its terms.

Of course, Code § 508 does not require the advancement of any particular charitable purpose, historic or otherwise, nor does it constrain charities from amending their purposes clauses. It thus appears that Code section 508 embraces the dynamic charter fidelity norm, albeit as long as the charter incorporates the private foundation excise tax strictures.

C. Unrelated Business Income Tax Regulations

Code § 511 imposes a tax on the unrelated business taxable income (UBTI) of tax-exempt entities, including charities.[275] UBTI is generally the income that an organization derives from an unrelated trade or business that the organization regularly carries on.[276] Under the Code, an "unrelated trade or business" of an organization is "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" exempt functions.[277] The Treasury regulations further clarify the precise meaning of an "unrelated trade or business."[278] Under the regulations, a charity derives income from an unrelated trade or business "if the conduct of the trade or business which produces the income is not substantially related (other than through the production of funds) to the purposes for which exemption is granted."[279] The regulations further state as follows:

> 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. Thus, for the conduct of trade or business from which a particular amount of gross income is derived to be substantially related to purposes for which exemption is granted, the production or distribution of the goods or the performance of the services from which the gross income is derived must contribute importantly to the accomplishment of those purposes. Where the production or distribution of the goods or the performance of the services does not contribute importantly to the accomplishment of the exempt purposes of an organization, the income from the sale of the goods or the performance of the services does not derive from the conduct of related trade or business. Whether activities productive of gross income contribute importantly to the accomplishment of any purpose for which an organization is granted

275. *See* I.R.C. § 511(a) (2006).
276. *See* I.R.C. § 512(a) (2006).
277. I.R.C. § 513(a) (2006).
278. Treas. Reg. § 1.513-1(d)(1) (1967).
279. *Id.*

> exemption depends in each case upon the facts and circumstances involved.[280]

Of particular importance is the UBTI-avoidance requirement that an entity's activities help accomplish a purpose for which the organization was granted exemption. Not just any charitable purpose will do, however. For example, in Revenue Ruling 73-105,[281] the IRS ruled that a tax-exempt folk art museum's sale of scientific books and city souvenirs constitutes an unrelated trade or business, notwithstanding that other items sold in the museum shop, such as reproductions of folk art and instructional literature in art, are related to its exempt function. In ruling that the sale of scientific books and city souvenirs is an unrelated trade or business, the IRS reasoned as follows:

> [S]cientific books and souvenir items relating to the city where the museum is located have no causal relationship to art or to artistic endeavor and, therefore, the sale of these items does not contribute importantly to the accomplishments of the subject organization's exempt educational purpose which, as an art museum, is to enhance the public's understanding and appreciation of art. The fact that some of these items could, in a different context, be held related to the exempt educational purpose of some other exempt educational organization does not change the conclusion that in this context they do not contribute to the accomplishment of this organization's exempt educational purpose.[282]

In determining whether an activity constitutes an unrelated trade or business, the Treasury regulations and interpretations thereof by the IRS clearly examine not simply whether an activity substantially relates to a charitable purpose, but whether the activity substantially relates to the specific exempt purpose of the organization in question.[283] At a minimum, then, the UBTI authorities embrace some form of charter fidelity norm. One could also interpret Revenue Ruling 73-105 to embrace some type of mission fidelity norm, insofar as the ruling focuses extensively on precisely what the organization does—operating a folk art museum. Nothing in these authorities purports to bind the organization to its historic purposes or to its historic mission, however. Thus, the UBTI rules appear to embrace the dynamic charter fidelity norm, and perhaps even the dynamic mission fidelity norm. To deviate from these norms is not necessarily to forfeit federal income tax exemption, of course; in many cases, the penalty for

280. Treas. Reg. § 1.513-1(d)(2).
281. Rev. Rul. 73-105, 1973-1 C.B. 264.
282. *Id.*
283. *See, e.g.*, *id.*

straying from an organization's exempt purposes is simply incurring the tax on UBTI.[284]

D. Conclusion

Federal tax law clearly promotes the charity advancement norm and its negative corollary.[285] Some elements of the tax system appear to assume the adoption of the dynamic charter fidelity norm, as well.[286] In only one instance is another norm, the dynamic mission fidelity norm, even arguably embraced—the definition of an unrelated trade or business.[287] The most compelling observation from this survey is that the federal tax system appears to be designed to encourage charity fiduciaries to devote themselves to the task of ensuring that their governed entities advance some charitable purpose and refrain from advancing non-charitable purposes.

Most of the details of how best to manage charities so as to advance charitable purposes and refrain from advancing non-charitable purposes are left to the judgment of fiduciaries. However, in its regulation of private foundations, supporting organizations, and donor-advised funds, the law has increasingly encroached upon this judgment by limiting the ability of charities to engage in certain activities that could be, but are not necessarily, inconsistent with the charity advancement norm and its negative corollary.[288]

V. ASSESSMENT OF FEDERALIZED OBEDIENCE NORMS

This part evaluates the federalization of obedience norms under United States tax laws. Part V.A identifies assumptions underlying the tax system's promotion of the charity advancement norm and its negative corollary. Next, Part V.B discusses the federal interest in adopting obedience norms. Finally, Part V.C discusses how the law should continue to develop in its pursuit of advancing the legitimate federal interests identified previously.

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284. *See* I.R.C. § 511(a).
285. *See supra* Parts IV.A, IV.B.2.
286. *See supra* Parts IV.A.1, IV.B.3, IV.C.
287. *See supra* Part IV.C.
288. *See supra* Part IV.B.2.

A. Assumptions Underlying Federal Tax Law's Promotion of Obedience Norms

Important assumptions appear to underlie the advancement of obedience norms through federal tax law.[289] These assumptions relate to the inadequacy of state law fiduciary standards and enforcement mechanisms; the degree to which the fundamental income tax exemption requirements ensure adherence to obedience norms; and other assumptions, sometimes conflicting, that relate to the behavior of fiduciaries and donors (and related persons) and appear to underlie the federal excise tax system governing charities.[290] This analysis is an overview, rather than a comprehensive assessment, of assumptions apparently underlying the tax system's perpetration of obedience norms governing charity fiduciaries.

One apparent assumption of the fundamental income tax exemption requirements and the federal excise tax regime governing charities is that state law alone does not adequately ensure compliance with obedience norms.[291] Otherwise, federal tax law could simply exempt charities from federal income tax and defer to state law enforcement mechanisms to ensure that charity fiduciaries advance charitable purposes. Although the assumption may be grounded in part on the belief that state attorneys general cannot alone adequately monitor the charitable sector,[292] it also apparently rests on the premise that state laws alone are unlikely to ensure that charity fiduciaries will manage their organizations in compliance with the charity advancement norm and its negative corollary. Were state law standards thought sufficient, Congress could simply condition federal income tax exemption on compliance with state laws governing charities.[293]

Certain provisions of federal tax law also assume that the prospect of failing to satisfy the fundamental exemption requirements is often insufficient to ensure that charity fiduciaries will comply with the charity advancement norm and its negative corollary.[294] Otherwise, there would be no need for a federal excise tax regime that penalizes fiduciaries and charitable entities for engaging in transactions that are, or could be,

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289. The analysis of this part reflects and builds upon prior work of the author. *See, e.g.*, Buckles, *Duty of Loyalty*, *supra* note 199, at 681–85.

290. *Id.* at 681.

291. *Cf.* Gary, *supra* note 1, at 629 (stating that "concern about whether adequate monitoring of charities exists has led to increasing regulation through the IRS").

292. On the limits of enforcement by state attorneys general, see, e.g., Brody, *Whose Public?*, *supra* note 1, at 946–50; Fishman, *supra* note 1, at 576–77; Gary, *supra* note 1, at 623–24; Kenneth L. Karst, *The Efficiency of the Charitable Dollar: An Unfulfilled State Responsibility*, 73 HARV. L. REV. 433, 451–52 (1960); 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); Manne, *supra* note 1, at 250–51.

293. *Cf.* Mayer & Wilson, *supra* note 2, at 480–81 (discussing enhanced federal interest in regulating the governance of charities).

294. *See, e.g.*, I.R.C. §§ 4941; 4942; 4943; 4945; 4958; 4966; 4967 (2006).

inconsistent with the charity advancement norm and its negative corollary. At least two reasons may explain the assumed insufficiency of the fundamental exemption requirements. One plausible explanation is that the fundamental exemption requirements implementing the charity advancement norm and its negative corollary are fairly broad, and Congress believes that certain behaviors are so unlikely to accomplish any public purposes meaningfully, or so likely to advance a non-charitable purpose, that they should effectively be prohibited—via the disincentives produced by the excise tax regime.[295] Such activities include unsupervised grants to non-charitable entities by private foundations and DAFs, grants to individuals from DAFs, attempts by private foundations to influence legislation, and various conflict-of-interest transactions between insiders and some charitable entities notwithstanding that the transactions could be fairly priced by market standards.[296]

Another reason that the fundamental exemption requirements are buttressed with the excise tax regime may be that the former do not sufficiently align the financial interests of charity managers with those of the managed entities. A fiduciary who desires to use her charity to promote a non-charitable purpose may care little that the penalty for her malfeasance is the loss of the entity's federal income tax exemption. In contrast, she would care greatly about incurring a management-level excise tax liability on account of exploiting the charity. Although the fundamental exemption requirements promote the charity advancement norm and its negative corollary, they are weaker enforcement mechanisms than are those excise taxes applied at the level of management.[297]

Federal tax laws apparently intended to embrace the charity advancement norm and its negative corollary also appear to reflect conflicting assumptions about fiduciary behavior.[298] As I have observed elsewhere,[299] conflicting assumptions abound concerning whether the risk of exploitation of charities by insiders is sufficiently high to tolerate conflict-of-interest transactions ostensibly entered into on terms that are fair to the charity.[300] The private foundation self-dealing excise tax regime[301] generally assumes that directors cannot be trusted to exercise their duty of

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295. *See supra* Part IV.B.2.

296. *See supra* Part IV.B.2.b.

297. *Cf.* Dana Brakman Reiser, *Charity Law's Essentials*, 86 NOTRE DAME L. REV. 1, 10–11 (2011) (observing that the EBTET statute and regulations "better align available remedies with the aim of maintaining charities' other-regarding orientation" than loss of federal income tax exemption because the EBTET penalizes fiduciaries directly).

298. For a discussion of these inconsistent assumptions underlying the excise taxation of compensation, see Buckles, *Fiduciary Assumptions*, *supra* note 199, at 104–07.

299. *See* Buckles, *Duty of Loyalty*, *supra* note 199, at 683–85.

300. *Id.*

301. *See* I.R.C. § 4941 (2006).

loyalty under state law.[302] However, the rule permitting payment of reasonable compensation for personal services provided by a disqualified person to a private foundation[303] rests on a contrary assumption. So does the general approach of the EBTET, which implements a standard (fairness, based on market value) to govern most transactions between a charity and an insider.[304] However, certain "fair" transactions between an SO and a major donor—namely, those involving loans, compensation, and similar payments—are taxed.[305] The federal tax regime appears to assume that were major donors to an SO and related persons were permitted to enter certain kinds of transactions with an SO, the expected loss from exploitation of the charity would exceed the expected loss from the under-performance of services that may result from current law. The excise tax applied to DAF insiders[306] assumes essentially the same with respect to the same class of transactions. Inexplicably, however, other conflict-of-interest transactions between an SO and a major donor, or between a DAF and a DAF insider, are apparently assumed to be benign. For example, sales of assets between these parties are subject to the general EBTET regime and its market-based fairness standard.[307]

More generally, even in the context of transactions not involving a financial conflict of interest between the charity and its fiduciaries or its major donors, the federal tax regime appears to rest on irreconcilable assumptions. For example, the excise tax regime appears to assume that private foundation managers are capable of making many forms of grants to individuals in a manner consistent with the charity advancement norm, for only certain types of grants to individuals must satisfy procedural safeguards,[308] and even those are not especially onerous. In contrast, the rule taxing any distribution from a DAF to a natural person[309] appears to assume that the managers of organizations that sponsor DAFs cannot be trusted to evaluate donors' recommendations of grants to individuals. The disparate assumptions could be explained by the theory that fiduciaries governing organizations that sponsor DAFs are less attentive to the operation of DAFs than are private foundation trustees with respect to their operations. But this explanation is inconsistent with the fact that in certain other respects, the law appears to assume that private foundations need more regulation than DAFs. For example, sales and leases of assets between a private foundation and disqualified persons are effectively

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302. *See* Buckles, *Duty of Loyalty*, *supra* note 199, at 683.
303. *See* I.R.C. § 4941(d)(2)(E).
304. *See* I.R.C. § 4958 (2006).
305. *See* I.R.C. § 4958(c)(3)(A)(i)(I), (B)(i)–(iii).
306. *See* I.R.C. § 4958(c)(2)(A).
307. *See* I.R.C. § 4958 (2006).
308. *See* I.R.C. § 4945(d)(3), (g) (2006).
309. *See* I.R.C. § 4966(a), (c)(1)(A) (2006).

prohibited,[310] whereas the same transactions between a DAF and a DAF insider are not.

In a similar vein, several excise tax provisions seem to assume that private foundations are more likely than SOs to further non-charitable purposes absent governmental intervention. For example, the private foundation excise tax on taxable expenditures[311] has no strong parallel in the taxes applicable to SOs. The excise tax on private foundation taxable expenditures thus suggests that Congress trusts private foundation fiduciaries less than those governing SOs. But if that is so, it makes little sense to subject reasonable compensation paid by an SO to a substantial contributor to excise tax, when the private foundation self-dealing excise tax does not apply to reasonable compensation paid to a substantial contributor for personal services necessary to carry out the foundation's exempt purposes.[312]

Federal tax law also appears to assume that charities that depend on a broad base of donors or other stakeholders need less federal regulation through the tax system of their adherence to obedience norms than do those that are less dependent on donors and other stakeholders. Elsewhere, I have analyzed this issue in depth in the context of discussing payout requirements and other distribution-related rules governing various types of charities.[313] I simply summarize the basic point here.

In general, the types of charities regulated the least by the federal tax regime are the unaffiliated public charities, which rely on funding from a fairly broad group of donors and, in the case of churches, schools, and hospitals, tend to answer to other stakeholders who monitor the entity.[314] The most heavily regulated entities are those that appear to be monitored less closely by the donating general public—private foundations and (arguably) DAFs.[315] The regulation of SOs tends to depend on the degree to which their publicly funded supported organizations can be expected to supervise the operations of the SO.[316] SOs that are tightly controlled by their supported organizations are generally less regulated through the federal tax laws than other SOs.[317] The tax regime thus appears to assume that, with a few exceptions, a charity's reliance on support from the general public obviates the need for the tax system to highly regulate charitable

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310. *See* I.R.C. § 4941(d)(1)(A).

311. *See* I.R.C. § 4945 (2006).

312. *See* I.R.C. § 4941(d)(2)(E).

313. *See* Buckles, *Private Foundation Substitutes*, *supra* note 199, at 509–30.

314. *See id.* at 511–12, 515, 528–29.

315. For reasons that I have discussed previously, the law probably should distinguish between organizations that maintain a small percentage of total assets in DAFs and those that hold a significant portion of their assets in DAFs. *See id.* at 527–28.

316. *See id.* at 517–26.

317. *See id.*

activities beyond basic requirements for maintaining federal income tax exemption.

In circumstances not involving conflicts of interest,[318] this assumption is sensible if the "market in altruism" effectively regulates the behavior of charity fiduciaries.[319] Apparently, the donating public is generally believed capable of monitoring a charity's operations and expressing its assessment through funding choices so effectively that a charity's board will respond to the public's assessment of whether the entity is sufficiently advancing charitable goals. The Code's apparent reliance on the public's oversight of publicly funded charities implies that Congress believes that whatever objectives it would achieve through more direct regulation of charitable activities through tax laws are adequately served by relying on the public to monitor charities—if and only if the charities are directly or indirectly accountable to the donating public or a broad base of other stakeholders. Not only does Congress assume that those charities are accountable to the public, but it also assumes that the public monitoring is sufficient to preempt detailed direct governmental regulation of the charities' judgment on how best to accomplish charitable goals. In the case of organizations that are not thought to be directly or indirectly accountable to the donating general public or analogous stakeholders—such as private foundations, certain Type III SOs, and DAFs—Congress appears to assume that more detailed tax rules promoting the charity advancement norm and its negative corollary are necessary.[320]

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318. Code section 4958 imposes an excise tax on excess benefit transactions between certain insiders and public charities. *See* I.R.C. § 4958 (2006). Augmenting the basic prohibition against private inurement of a charity's net earnings, *see* I.R.C. § 501(c)(3) (2006), the excess benefit transactions excise tax increases the cost of exploiting a charity intentionally or through negligence. The tax obviously reflects a congressional judgment that conflict-of-interest transactions are not sufficiently regulated by state fiduciary law and the market in altruism.

319. The "market in altruism" features prominently in the donative theory of federal income tax exemption advanced by Professors Mark Hall and John Colombo. *See* Mark A. Hall & John D. Colombo, *The Donative Theory of the Charitable Tax Exemption*, 52 OHIO ST. L.J. 1379, 1410 (1991). In explaining the role of donations, Hall and Colombo state as follows:

> The market in altruism works as follows. Those donors who desire to make some personal contribution to the betterment of society will have many choices from which to satisfy this desire. They will naturally tend to choose the outlet that provides the most satisfaction. We can generally assume that, for most donors, this will be the worthy objects they perceive as needing the most support. However, as gifts combined with subsidies begin to approach the socially desired level (as measured through the perceptions of those inclined to give), gifts will begin to taper off. In stable social settings, these countervailing forces may settle at an equilibrium, but as social conditions change, this market in altruism redirects philanthropy and the accompanying tax subsidy to new objects. That some giving is uninformed, over-reactive, or otherwise might come from donors who are oblivious to social worth or need is troubling, but no more so than similar defects in the private or political markets. Moreover, the fact that a recipient must show a substantial level of donative support before qualifying for the charitable exemption means that minor aberrational patterns are usually screened out.

Id.

320. *Cf.* Mayer & Wilson, *supra* note 2, at 487 (observing the need for heightened oversight of charities that do not depend on donations for financial support).

B. The Federal Interest in Adopting Obedience Norms

The government has a strong interest in federalizing the charity advancement norm and its negative corollary. As discussed previously, the public benefit purpose is the most basic purpose of obedience norms.[321] A purpose is not "charitable" unless the law considers it beneficial to the public.[322] In oversimplified terms, the government refrains from taxing entities that perform tax-exempt charitable functions because the government has deemed the functions beneficial to the public.[323] Requiring adherence to the charity advancement norm and its negative corollary helps ensure that the public in fact benefits from the operations of charitable organizations.[324] Accordingly, the promotion of the charity advancement norm and its negative corollary through the organizational and operational tests, the prohibition against private inurement of net earnings, and the prohibition against excessive private benefit are all entirely sensible.[325] Further, excise tax provisions that better align the financial interests of fiduciaries with the charity-enhancing interests of the organizations that they oversee can also promote adherence to the charity advancement norm and its negative corollary. Thus, properly designed, management-level excise taxes can serve a valid federal interest.

There is no readily apparent federal interest in requiring adherence to the static obedience norms—e.g., static charter fidelity and historic mission fidelity—at least in contexts not involving donor-restricted charitable gifts.[326] The public benefit purpose of obedience norms is served without regard to whether the specific charitable purpose advanced by an entity is old or new, and thus, it is difficult to discern why the charity income tax exemption necessarily should depend directly on the longevity of an organization's exempt purposes. Moreover, as discussed previously,

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321. *See supra* Part III.D.

322. *See supra* note 93.

323. More precise explanations for the federal income tax exemption of charities abound in the literature. *See generally* Rob Atkinson, *Altruism in Organizations*, 31 B.C. L. REV. 501 (1990); Boris I. Bittker & George K. Rahdert, *The Rationale for Exempting Organizations from Corporate Income Taxation*, 85 YALE L.J. 299 (1976); Evelyn Brody, *Of Sovereignty and Subsidy: Conceptualizing the Charity Tax Exemption*, 23 J. CORP. L. 585 (1998); Johnny Rex Buckles, *The Community Income Theory of the Charitable Contributions Deduction*, 80 IND. L.J. 947 (2005); 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); Hall & Colombo, *supra* note 319; Henry B. Hansmann, *The Rationale for Exempting Non-Profit Organizations from Corporate Income Taxation*, 91 YALE L.J. 54 (1981). For a summary of the major theories supporting the exemption of charitable organizations from federal income taxation, see Johnny Rex Buckles, *The Case for the Taxpaying Good Samaritan: Deducting Earmarked Transfers to Charity Under Federal Income Tax Law, Theory and Policy*, 70 FORDHAM L. REV. 1243, 1284–96 (2002).

324. *See supra* Part III.A.

325. *See supra* Part IV.A.

326. Restricted gifts raise special federal income tax issues. For a discussion of some of these issues, see Buckles, *supra* note 101, at 1843–64.

although one may articulate plausible, albeit debatable, purposes for obedience norms that tend to justify the static norms,[327] the most compelling of these contestable purposes, reliance-based equity,[328] is more naturally the concern of state courts and attorneys general than of the federal government.

There may be some federal interest in promoting adherence to the dynamic obedience norms—dynamic charter fidelity and dynamic mission fidelity—although I am not convinced that this is generally the case. One could argue that requiring a charity to advance the charitable purposes expressed in its charter under federal tax law invites cooperation with state enforcement authorities. To operate contrary to charter purposes is to invite an action by the state attorney general, who in theory can notify the IRS of the deviation. However, there is no real reason to require dynamic charter fidelity under federal law if the goal is to buttress federal oversight. The most important issue for federal tax purposes is whether the charter deviation is consistent with the charity promotion purpose. State attorneys general can notify the IRS of charter deviations whether or not federal tax law requires dynamic charter fidelity, and, upon receiving this notice, the IRS can decide whether the deviation represents a departure from fulfilling a charitable purpose. In other words, notice of charter deviations *from* attorneys general does not require federal tax law to adopt any version of charter fidelity norms. On the other hand, if the goal is to enlist the federal government in aiding state enforcement by providing notice of charter deviations *to* state attorneys general, then imposing a dynamic charter fidelity norm federally would further this goal.

As discussed above, there is one context in which dynamic charter fidelity, and perhaps even dynamic mission fidelity, appears to be required—when an organization seeks to avoid taxation of income from a trade or business that it regularly carries on.[329] In that context, the income in question is not taxable only if the underlying activity contributes importantly to the organization's actual exempt purposes. Fiduciaries are thereby encouraged to ensure that the entity that they oversee advances its specific exempt purposes. Nonetheless, this rule probably does not reflect a general attempt to embrace the dynamic charter fidelity norm or the dynamic mission fidelity norm through federal tax law. First, the rule does not affect organizations that refrain from engaging in a trade or business.[330] Second, the required nexus between the activity and the entity's specific exempt purposes exists to prevent unfair competition with taxable entities, the purportedly primary purpose of the UBIT.[331] If an entity could avoid

327. *See supra* Part III.B–C.
328. *See supra* Part III.B.
329. *See supra* Part IV.C.
330. *See* I.R.C. § 511 (2006).
331. *See* H.R. REP. NO. 81-2319, pt. III(E)(I), at 36 (1950), *reprinted in* 1950-2 C.B. 380, 409.

UBIT by demonstrating that an income generating activity contributed to the accomplishment of some charitable purpose (but not one of its own exempt purposes), charities might engage in more commercial endeavors, thereby aggravating the perceived problem of unfair competition with taxable firms.[332]

C. The Future of Federal Tax Law and Obedience Norms

Having explained that the governmental interest in federalizing the charity advancement norm and its negative corollary is strong, and that the governmental interest in broadly federalizing other obedience norms is far less clear, this paper now turns to the question of the implications for tax reform.

1. Implications for Reforming the Federal Excise Tax Regime According to Rational Uniformity

The labyrinthine excise tax regime is ripe for legislative overhaul. As explained in Part V.A, the assumptions underlying the federal excise tax regime, more than any other feature of the tax system's regulation of charities, are hopelessly in tension. The excise tax rules simply cannot be justified coherently. Private foundations are most heavily regulated through a regime that over-inclusively promotes the negative corollary of the charity advancement norm because Congress distrusts private foundation directors and trustees more than the fiduciaries of other charities. Nonetheless, the rule that allows private foundation fiduciaries to compensate their large donors for necessary professional services[333] treats private foundations less suspiciously than DAFs and SOs. Private foundations also can make grants to individuals[334]—in some cases without following special statutory procedures—notwithstanding that DAFs cannot.[335]

However, one must not thereby surmise that congressional suspicion of DAFs exceeds that of private foundations, for many transactions between DAFs and DAF insiders are evaluated under the general fairness standard of the EBTET regime,[336] rather than the nearly absolute prohibition of non-compensatory conflicts-of-interest transactions between private foundations and their fiduciaries and major donors.[337] Further, DAFs are not currently

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332. Whether "unfair competition" is truly a concern is irrelevant to the textual point. For an analysis of this issue, see Susan Rose-Ackerman, *Unfair Competition and Corporate Income Taxation*, 34 STAN. L. REV. 1017 (1982).

333. *See* I.R.C. § 4941(d)(2)(E) (2006).

334. *See* I.R.C. § 4945(d)(3) (defining "taxable expenditure" to include certain grants to individuals, but not others) (2006).

335. *See* I.R.C. § 4966(a), (c)(1)(A) (2006).

336. *See generally* I.R.C. § 4958 (2006).

337. *See generally* I.R.C. § 4941(d)(1) (2006).

subject to a payout rule analogous to that governing private foundations.[338] The payout rule is Congress's primary tool for ensuring positive compliance with the charity advancement norm by private foundations. Considering that DAFs currently need not comply with such a rule implies that Congress recognizes that fiduciaries of organizations sponsoring DAFs can be trusted to observe the charity advancement norm without further regulation through the tax system.

Neither heads nor tails can be made of the tax system's implementation of the charity advancement norm and its negative corollary in the case of SOs. The rule effectively prohibiting SOs from compensating major donors[339] is more restrictive than the rule governing compensation paid to private foundation donors.[340] Further, non-functionally integrated Type III SOs are subject to the excess business holdings excise tax long applicable to private foundations,[341] and proposed regulations would impose a payout requirement on them.[342] However, in the case of conflict-of-interest transactions not involving loans to disqualified persons and not involving compensation, grants, or similar payments to major donors, all SOs, even Type III SOs, are subject to the general EBTET regime and its fairness standard.[343] Likewise, no SO is subject to a regime that approximates the private foundation excise taxes on taxable expenditures.[344] Further, Type I SOs and Type II SOs are generally free of quantitative payout requirements and the excess business holdings excise tax.[345]

Some implications for reform are apparent. Congress should identify a rational basis for determining what types of charities do and do not require greater regulation through the tax system and then reform the Code so as to differentiate among charities that present different levels of risk. A good starting point is the premise that charities need less regulation if they rely on broad public funding or are otherwise accountable to a large number of stakeholders.[346] In the case of unaffiliated public charities, Congress probably has the right idea in imposing only the most basic charity

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338. *See generally* I.R.C. § 4942 (2006).

339. *See* I.R.C. § 4958(c)(3)(A)(i)(I) (2006).

340. *See* I.R.C. § 4941(d)(2)(E) (2006).

341. *See* I.R.C. § 4943(f)(3)(A) (2006).

342. *See Payout Requirements for Supporting Organizations That Are Not Functionally Integrated*, 74 Fed. Reg. 48672 (Sep. 24, 2009).

343. *See generally* I.R.C. § 4958 (2006).

344. *See* I.R.C. § 4945 (2006).

345. However, a Type II SO that accepts any gift or contribution from any person described in § 509(f)(2)(B) (i.e., a person who controls the SO's supported organization) is subject to the excess business holdings excise tax. *See* I.R.C. § 4943(f)(3)(B) (2006).

346. *See* Benjamin Leff, *Federal Regulation of Nonprofit Board Independence: Focus on Independent Stakeholders as a 'Middle Way,'* 99 KY L.J. 731, 777–81 (2010–2011); *id.* at 780 ("Once the IRS has identified organizations that it thinks pose a potential danger of being operated to advance a substantial private purpose, an analysis of meaningful independent stakeholders can assist an evaluation of whether conditioning exemption on the existence of some sort of 'independent' board is warranted.").

advancement norms and in promoting the negative corollary of the charity advancement norm through excise tax provisions that are not over-inclusive. By extension, the same general approach appears sensible when the charity is *indirectly* monitored by the same donors or stakeholders. Thus, Type I SOs and Type II SOs, which are controlled by or with public charities, probably do not require more regulation than do their supported organizations. More regulation may be sensible in the case of private foundations and Type III SOs, however. Whether DAFs should be treated more like private foundations or public charities probably depends on the degree to which their sponsoring organizations are likely to face close monitoring by the general public. As I have argued in another paper, a sponsoring organization that holds only a modest portion of its assets in DAFs may well be more responsive to the general public than one which holds most of its assets in DAFs.[347]

Even when an organization is not accountable to a broad base of donors or other stakeholders, there may be other objectively determinable grounds for regulating it less heavily through the tax system. For example, a private foundation or Type III SO that is governed by a board of directors who are largely unrelated to one another and to large donors through family, employment, or other business ties is probably less likely to exploit the charity in conflict-of-interest transactions than is a charity dominated by related persons. Thus, one way the law could develop is to impose a fairness standard uniformly on conflict-of-interest transactions approved by directors largely unrelated to one another and large donors, even in the case of private foundations and Type III SOs.[348]

Reforming the current excise tax regime along the lines suggested promotes rational uniformity, which I have argued for previously.[349] Rational uniformity does not require that only one set of standards for promoting the charity advancement norm and its negative corollary govern fiduciaries through the tax system.[350] It does, however, demand that the tax regime subject fiduciaries who direct their charities in such a way as to present the same risks of exploitation, and the same propensity to promote public purposes, to the same obedience rules.[351] For reasons already explained, rational uniformity in the promotion of obedience norms through the federal tax regime is currently lacking. But tax reform can embrace rational uniformity, as it should. Rational uniformity is a worthy objective because it promotes efficient transactions between fiduciaries and charities, and discourages those that pose great risks of inefficiency; it tends to promote enforcement and compliance with the Code, insofar as logical rules

347. *See* Buckles, *Private Foundation Substitutes*, *supra* note 199, at 527–28.
348. *See* Buckles, *Fiduciary Assumptions*, *supra* note 199, at 111–12.
349. *See* Buckles, *Duty of Loyalty*, *supra* note 199, at 686–87.
350. *See id.*
351. *See id.*

are easier to understand and apply; and it tends to promote equity, insofar as fiduciaries who engage in similar behavior are treated similarly.[352]

2. Implications for Encouraging Public Disclosure

If charities generally need less regulation through the tax system when they rely on broad public funding or are otherwise accountable to a large number of stakeholders, another implication follows. The donating public and other stakeholders need reliable information concerning how effectively the charity is complying with the charity advancement norm and its negative corollary. The expanded reporting required by the recently revised Form 990,[353] which must be made available to the public[354] and filed with the IRS,[355] is a helpful development in ensuring meaningful review of a charity's operations. Should Congress become concerned that charities are failing to comply with the charity advancement norm or its negative corollary in some particular instance (e.g., in devoting a significant percentage of revenue directly to carrying out exempt activities, in administering grant programs, in managing DAFs, or in compensating major donors for services rendered), perhaps the best initial course of action is to require expanded reporting of the activities that raise concerns. When donors and other stakeholders receive greater and more useful information about a charity's operations, they can better monitor charities and use non-legal sanctions to pressure charities to correct problems. Better information can also aid the IRS and state enforcement agencies in auditing and otherwise investigating areas of concern.[356]

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352. *See id.* at 687.

353. An electronic copy of Form 990 and the instructions thereto are available on the official IRS website at http://www.irs.gov/charities/article/0,,id=233830,00.html. For a summary of the changes made by the new Form 990, see *Background Paper, Forms 990, Moving from the Old to the New* (Aug. 19, 2008), *available at* http://www.irs.gov/pub/irs-tege/moving_from_old_to_new.pdf.

354. *See* I.R.C. § 6104(d)(1)(A)(ii), (B) (2006); Treas. Reg. § 301.6104(d)-1(a) (as amended in 2000). An organization is not required to comply with a request for a hard copy of its annual information return if it has made the return "widely available." *See* Treas. Reg. § 301.6104(d)-2(a) (as amended Jan. 13, 2000). An organization can satisfy this requirement by posting the return on its Web page or by having the return posted in a database of similar documents of other tax-exempt organizations on a Web page established and maintained by another entity. *See* Treas. Reg. § 301.6104(d)–2(b)(2)(i).

355. *See* I.R.C. § 6033(a)(1), (B) (2006).

356. *See generally* Evelyn Brody, *Sunshine and Shadows on Charity Governance: Public Disclosure as a Regulatory Tool*, 12 FLA. TAX REV. 183 (2012) (discussing the benefits of disclosing a charity's activities to its governing board, its donors, government regulators, and others).

3. Implications for Evaluating the Role of Over-Inclusive Rules in Federal Tax Law

Over-inclusive rules have obvious strengths and weaknesses. On the positive side, by broadly stamping out classes of transactions consisting of many individual cases of impropriety, over-inclusive rules significantly decrease the likelihood that charities will be exploited. On the other hand, if a prohibited class of transactions is likely to contain only a few problematic cases, the losses from prohibiting many value-enhancing transactions may exceed the gains from discarding the few bad apples. Congress should not respond to a few bad apples by burning the whole orchard.

Not all rules that seek to ensure compliance with the negative corollary of the charity advancement norm over-inclusively are necessarily misguided. For example, a private foundation's grant to a non-charitable grantee for a legitimate charitable purpose may well serve that purpose even if the private foundation fails to report to the government pursuant to the required exercise of expenditure responsibility.[357] The failure to report subjects the foundation to an excise tax,[358] a seemingly unjust result if the grant actually advances charity. Nonetheless, this over-inclusive rule is probably justified by the risk that if foundations are not required to report to the IRS on the status of grants to non-charities, some may make grants that do not, in fact, serve charitable ends.

However, the utility of some over-inclusive rules is more suspect. Consider the private foundations excise tax on excess business holdings.[359] The tax was justified, in part, under the theory that large ownership stakes in business enterprises would detract foundation managers from pursuing charitable programs because of their preoccupation with business operations.[360] However, no small measure of attention is surely required to oversee the large, diversified investment portfolios of modern private foundations, many of which include alternative investments, notwithstanding the limitations imposed on the percentage of equity in any single company that private foundations may hold. At a minimum, this congressional rationale for the excess business holdings excise tax is questionable.[361]

Another over-inclusive rule is one that generally taxes distributions from DAFs to a natural person.[362] Absent good evidence that distributions

357. *See* I.R.C. § 4945(h)(3) (2006).

358. *See* I.R.C. § 4945(a)(1), (b)(1), (d)(4)(B), (h)(1)–(3).

359. I.R.C. § 4943 (2006).

360. *See* STAFF OF JOINT COMM. ON TAXATION, 91ST CONG., GENERAL EXPLANATION OF THE TAX REFORM ACT OF 1969, Part III.A.4 (Comm. Print 1970).

361. The same may be said of the extension of the excess business holdings excise tax to DAFs and certain SOs.

362. I.R.C. § 4966(c)(1)(A) (2006).

from DAFs to individuals are likely not to advance charitable purposes, the effective prohibition on most such distributions may do more to shape the form of charity than to prevent the exploitation of charity. It is possible that organizations whose assets are held primarily in DAFs are not sufficiently attentive to the recommendations of DAF insiders as to distributions from DAFs. If that is so, one can readily imagine rules that would address the problem much more precisely. A form of expenditure responsibility could be required for all such distributions, or the specific rules governing private foundations in the case of grants to individuals could be applied.[363] Further, sponsoring organizations that maintain DAFs only as a minor portion of their total assets may, in fact, be quite attentive to distribution recommendations by DAF insiders. If so, perhaps no over-inclusive rule concerning distributions to individuals should apply to them.

Effectively prohibiting all SOs from compensating major donors for their services[364] is another over-inclusive rule. As I have observed elsewhere, it is doubtful that the risk of exploitation of SOs by their major donors is as high as that which exists in the case of private foundations (which may compensate donors for personal services).[365] Further, although effectively prohibiting SOs from compensating major donors essentially removes the risk that SOs will siphon off earnings in favor of donors through the charade of compensation, the prohibition can also lead to inefficiencies.[366] The over-inclusive rule comes at a price, and I am far from convinced that the benefits of the bright-line rule exceed its costs.

Thus far, this section of the paper has focused on the over-inclusiveness of certain excise tax rules. But one other feature of federal tax law also has great propensity to regulate charities over-inclusively—the public policy doctrine. No court, IRS agent, or legal commentator knows exactly what acting contrary to "established public policy" really means. Because I have extensively analyzed and critiqued the vagaries of the doctrine in two prior articles,[367] I will simply reiterate that the doctrine needs to be clarified and limited. I do believe that a refined, narrowed version of the public policy doctrine is sensible and necessary to promote the legality norm and the negative corollary of the charity advancement norm. The doctrine in its current form, however, invites judicial and administrative mischief of a sort that could greatly restrict the legitimate pursuit of charitable goals by institutions operating in a manner that deviates from the public vision of government actors.

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363. *See, e.g.*, I.R.C. § 4945(d)(3), (g)(3) (2006). Of course, the Code does permit distributions from accounts, which are technically defined as other than DAFs, to individuals for educational purposes in limited circumstances. *See* I.R.C. § 4966(d)(2)(B)(ii).

364. *See* I.R.C. § 4958(c)(3)(A)(i)(I), (B)(i)–(iii) (2006).

365. *See* Buckles, *Fiduciary Assumptions*, *supra* note 199, at 108–09.

366. *See id.*

367. *See supra* note 176.

4. Implications for Evaluating Legislative Efforts to Promote the Charity Advancement Norm

Few provisions of federal tax law require detailed actions that charity fiduciaries must take in complying with the charity advancement norm. The general organizational and operational tests permit wide latitude in the exercise of fiduciaries' judgment concerning how best to accomplish charitable goals.[368] Only private foundations and certain Type III SOs must concern themselves with mechanical payout rules.[369] The typically minimalist approach of the tax system in directing adherence to the charity advancement norm strikes me as both sensible and consistent with the legal tradition of this country.

Under the laws of most states, a charitable nonprofit corporation can incorporate for any purpose that the law recognizes as charitable without showing any special justification for the particular charitable purposes that the entity will advance.[370] Nor must charities generally justify their sustained existence by proving to the state that they are meeting especially pressing charitable needs. This laissez faire approach of the law governing charitable nonprofits is consistent with a model of charity that views the sector as distinct from government. The law supports the existence of a sector in which private actors and charity boards make decisions on how to foster the public good without being subjected to micro-management from public officials.[371] The modest point is simply that a vision of government oversight that requires detailed compliance with governmentally sanctioned charitable goals, or that invites ongoing, active government participation in the determination of whether specific charitable objectives are advisable, is a vision at odds with the pattern of charity law and policy in this country. As Professor Evelyn Brody has written, "charity management is located in the private sector precisely because society prefers reasonable discretion exercised by different participants under different conditions to the uniformity of government-directed action."[372]

Accordingly, I believe that Congress should generally resist the urge to require charities, as a whole, to comply with new laws intended to quantify compliance with the charity advancement norm. Specifying mandatory levels of university endowment spending for particular purposes, and greatly expanding the applicability of the commensurate-in-scope doctrine, are examples of the kind of legislation that is suspect. As argued previously, a better approach, at least in the case of entities directly or

368. *See supra* Part IV.A.1.

369. *See supra* Part IV.B.2.a.

370. *See generally State Filings for Nonprofits*, USA.GOV, http://www.usa.gov/Business/Nonprofit-State.shtml (last updated Mar. 7, 2012).

371. *See* Brody, *The Limits*, *supra* note 1, at 1407.

372. *Id.*

indirectly accountable to a broad segment of the donating public or other stakeholders capable of monitoring them, is probably to focus legislative and administrative energy on expanding and improving public disclosure of the activities of charitable entities.[373]

VI. CONCLUSION

Identifying the obedience norms that should guide charity fiduciaries is an important legal exercise. At the federal level, the government's interest in ensuring that charities serve a public purpose is clear, and, therefore, federal tax law properly requires charity fiduciaries to comply with the charity advancement norm and its negative corollary. The federal government appears to have little reason to enforce norms of static charter fidelity and historic mission fidelity. There may be modest benefits of promoting dynamic charter fidelity or even dynamic mission fidelity federally, but compelling adherence to the fundamental charity advancement norm and its negative corollary is most important.

Federal tax law helps ensure adherence to the charity advancement norm and its negative corollary primarily through fundamental exemption requirements (and related judicial and administrative doctrines) and the federal excise tax regime. However, the law does so imperfectly. This paper has identified various areas of concern. The most prominent is the current patchwork of inconsistent rules that characterize federal excise taxation of charities and their fiduciaries. The excise tax regime almost certainly fails to regulate the charitable sector rationally and efficiently so as to ensure optimal compliance with the charity advancement norm and its negative corollary. The conclusion that the excise tax system should be reformed seems inescapable.

373. *See supra* Part V.C.2.