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ARTICLES

CHARITY LAW'S ESSENTIALS

*Dana Brakman Reiser**

The boundary between charity and business has become a moving target. Social enterprises, philanthropy divisions of for-profit companies (most notably at Google), and legislation creating hybrid nonprofit/for-profit forms all use business models and practices to mold and pursue charitable objectives. This Article asserts that charity law must be streamlined in order to respond to these and other dramatic charitable innovations. My new vision of charity law centers around two essential requirements. First, charity law must continue to demand that charities maintain an other-regarding orientation, pursuing benefits for someone other than their own leaders and managers. Second, existing charity law must be revised and supplemented to mandate that charities utilize group governance. Additionally, this dual focus should be intensified by removing the limits on commercial and political activity that currently clutter charity law. These reforms will enhance charity law's ability to regulate traditional charities. Moreover, focusing charity law on its essentials will reveal the

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tools necessary to respond to the exciting developments blurring the boundary between charity and business.

INTRODUCTION

The boundary between charity and business has become a moving target. Google located its philanthropic efforts within its for-profit company, rather than in a traditional nonprofit foundation. Social entrepreneurs are forming for-profit companies to pursue environmental, educational, and public health objectives. Jurisdictions are creating hybrid forms of organization, which blend elements of a charity and those of a business enterprise. Scions of business speak of the need to incorporate social goals and responsibility into their models, in order to generate sustainable success. Yet, the serious shortcomings of current charity law thwart its ability to respond to these dramatic innovations. Legislators, regulators, and courts can enable charity law to do so by identifying and focusing on its essentials.

So, what are charity law's essentials? First, one must unpack the concept of "charity." To be a charity, an organization must pursue a charitable mission as its dominant and overriding purpose. Notably, such charitable missions go well beyond almsgiving. They embrace a broad array of missions, each pursuing some vision of the good, and include entities as diverse as the American Red Cross, your local community theater, and most U.S. law schools. The ways an individual charity achieves its charitable mission can and should evolve in response to changing times and circumstances. Still, the mission imperative remains the touchstone of what is a charity.

The problem with the mission touchstone, however, is enforcement. Accountability to mission is exceedingly difficult to measure and police. Perhaps some donors or patrons may be willing to monitor mission and withhold their support and patronage as a sanction, but these efforts will be limited and insufficient. Public enforcement threatens undesirable government influence on the content of charities' missions. Moreover, public enforcement of mission undermines charities' autonomy, the characteristic that enables them to be innovators, to take countermajoritarian positions, to serve the underserved.¹ Ultimately, charities must be trusted to police mission themselves.

¹ See, e.g., ALEXIS DE TOCQUEVILLE, *DEMOCRACY IN AMERICA* 513–17 (J.P. Mayer ed., George Lawrence trans., Anchor Books 1969) (1835); Barbara K. Bucholtz, *Reflections on the Role of Nonprofit Associations in a Representative Democracy*, 7 CORNELL J.L. & PUB. POL'Y 555, 572 (1998); David Horton Smith, *The Impact of the Volunteer Sector on Society*, in *THE NONPROFIT ORGANIZATION* 347, 347–55 (David L. Gies et al. eds., 1990); Lloyd Hitoshi Mayer, *The "Independent" Sector: Fee-for-Service Charity and the Limits of*

A key goal of charity law is thus to assist charity leaders and stakeholders in enforcing mission. Until now, discussions of charity law have argued the essential way that charity law does this is through the nondistribution constraint. A charity must reinvest its residual earnings in its mission to serve others, rather than route those earnings to individuals who possess organizational control.² Current charity law embodies this rule and the slightly more general idea that charities must use their assets to benefit some charitable class. This requirement that charities maintain an other-regarding orientation focuses charities on mission by declaring self-regarding behavior unacceptable. This basic command to serve others is, indeed, one of charity law's essentials.

Yet, other-regarding orientation is not alone sufficient. To enforce mission accountability, each charity must also be governed by a group, rather than by a single individual. Again, the tension between the mission touchstone and the challenge of its enforcement is the key. Society cannot and should not rigorously police the content of a charity's mission or the activities pursued in furtherance of it. Strong group governance creates a means for dialogue about how a charity meets and evolves its mission. Through collaboration and discourse, group governance offers an internal, structural solution for policing charitable mission. Notably, however, this essential principle is largely absent from current charity law. Charity law must be reformed to embrace group governance forcefully.

The necessary reforms to charity law do not stop with this addition. An important excision is also required. Current charity law is replete with attempts to prohibit or penalize charities' decisions to engage in commercial or political activity. These doctrines go far beyond discouraging self-regarding behavior and chill charities' pursuit of legitimate mission-related programs. Rather than promoting discussion of whether a commercial or political activity will support a charity's mission, these doctrines drive charities away from these activ-

Autonomy 24 (Notre Dame Law Sch., Legal Studies Research Paper No. 10-21, 2010), available at http://papers.ssrn.com/sol3/papers.cfm?abstract_id=1666421. Of course, there are those who would prefer a more limited vision of charity for the law, for example those who would require any entity recognized as a charity to be explicitly tied to relief of the poor.

² See Henry B. Hansmann, *The Role of Nonprofit Enterprise*, 89 *YALE L.J.* 835, 838 (1980) ("A nonprofit organization is, in essence, an organization that is barred from distributing its net earnings, if any, to individuals who exercise control over it, such as members, officers, directors, or trustees.").

ities wholesale. This ill-fated attempt to guard the border³ of what will serve charitable mission has generated vague categories and myriad exceptions that are easy for charities to avoid and nearly impossible for courts and regulators to police. This body of law might be read to suggest two further essentials: that charities should sharply limit their commercial undertakings, and that they should eschew involvement in politics. Such restrictions, however, are not essential to enforcing mission and the current charity law expressing them is, for the most part, wasted effort.

The time is ripe for a substantial reform of charity law, focusing it on other-regarding orientation and group governance and eliminating its misguided fixation on commercial and political activities. The rationalization of charity law would always be a welcome development to better regulate traditional charities, but the speed and variety of innovations blending charity and business demand action now. Emphasizing other-regarding orientation and group governance will allow us to discern and enforce the true line between charity and business. Jettisoning the commercial and political restrictions on charities will remove major impediments to innovators' use of traditional charity forms. Focusing on charity law's true essentials will enable it to respond to the exciting and sometimes vexing trend blurring charity and business.

Part I reviews how current charity law distinguishes charities from businesses, drawing on statutory pronouncements, regulatory activity, and common law decisions based on state organizational law and federal and state tax law. The other-regarding orientation requirement is fully expressed in these sources. The group governance norm's grip on current charity law is more tenuous, and this Part will identify several gaps that must be filled for it to achieve its potential as a structural solution to the challenge of enforcing mission accountability. Finally, this Part reviews the substantial body of law restricting the commercial and political activities of charities. Charting the contours of these rules and doctrines reveals a landscape in need of reform.

Part II introduces myriad innovations mingling charity and business that are pressuring charity law today. It argues these innovations can best be understood and regulated by refocusing charity law on the other-regarding orientation and group governance requirements alone. For-profit or hybrid organizational forms used to pursue chari-

³ See John Simon et al., *The Federal Tax Treatment of Charitable Organizations*, in THE NONPROFIT SECTOR RESEARCH HANDBOOK 267, 284–85 (Walter W. Powell & Richard Steinberg eds., 2d ed. 2006) (noting this “border patrol function” of tax exemption law).

table goals challenge the nondistribution constraint and other prohibitions on self-regarding behavior. The social enterprise trend also deeply challenges the group governance norm, as the structures used to maintain social goals within a for-profit business rely on preserving control with a founder. These challenges are serious and cut to the core of charity law—enabling self-regulation of mission. They highlight the need to continue charity law's vigilance regarding other-regarding orientation and to amplify its commitment to group governance.

Developments on the charity-business border are also pressuring current charity law's restrictions on commercial and political activity. Social enterprise, microfinance, and creative or philanthrocapitalism challenge the idea that charitable mission and commercial activity are incompatible. Social entrepreneurs who spurn charitable forms to avoid their political restrictions suggest that political activity may be necessary to achieve some charitable goals. Here, the experiences of innovators demonstrate the gains to be made by removing many of current charity law's limitations on commercial and political activity.

I. CURRENT CHARITY LAW

At the outset it is important to clarify and limit my claims. I argue that the other-regarding orientation and group governance requirements are the appropriate basis for *the law's* definition of a *charity*.⁴ The concept of a charity is more limited than that of a nonprofit organization more generally. Noncharitable entities may form as nonprofits, most commonly to pursue the mutual benefit of their members, such as in social clubs and trade associations.⁵ These entities may engage in some charitable activities, but they are not charities. The limitations that I argue are essential to charity status do not seriously constrain mutual benefit organizations. The limited focus on the proper emphasis of charity law also will not necessarily line up precisely with the general public's conceptions of charity. Indeed, gaps between any shared lay sense of charity's meaning and purpose and the essentials of charity law could signal a need for charity law to change.

4 This approach contrasts starkly with Professor Hill's proposal that federal tax law should abandon the treatment of exempt organizations as entities in favor of treating them as aggregates. See Frances R. Hill, *Targeting Exemption for Charitable Efficiency: Designing a Nondiversion Constraint*, 56 SMU L. REV. 675, 700 (2003). Although I share Professor Hill's conviction that avoiding diversion of charity resources should be an important goal of charity law, I believe that an entity approach remains helpful.

5 See MARILYN E. PHELAN, NONPROFIT ENTERPRISES §§ 23:01, 26:01 (2007) (discussing the nature of social clubs and trade associations generally).

It is equally important to be clear about the sources of charity law that I utilize. I look to the statutory, regulatory, and case law that defines and constrains a charitable entity, as opposed to some other type of entity (often a business). This body of charity law differentiates charities from other entities that happen to engage in charitable activities. This set of constitutive charity law, in my view, includes two important sets of regimes. The first is the state law that limits access to charitable forms of organization—principally, state nonprofit corporation and charitable trust law.⁶ The second is tax law that defines the charity category that entitles an entity to exemption. State property tax exemption is provided to charities by various state constitutional provisions or statutes.⁷ Federal income tax exemption law includes multiple classes of exempt entities.⁸ References to federal tax exemption refer to the most favored status for charitable entities, granted under Internal Revenue Code § 501(c)(3).⁹ It is important to distinguish this tax exemption regime from federal tax law delineating the types of entities entitled to receive tax-deductible contributions.¹⁰ These rules are of great importance to charities and certainly motivate their behavior; they also often contain limitations resonant of the essentials I articulate. Yet, the deductibility regime is aimed at encouraging behavior by donors and does not explicitly guard access to charity status. Therefore, I do not treat it as a primary source for the charity law concepts considered here.

Of course, one might view only state organizational law as constitutive of charity. Tax law might merely comprise political choices about the types of activities government will subsidize,¹¹ without nec-

6 Although a nonprofit organization may take the legal form of a charitable trust or an unincorporated association, most U.S. nonprofits are formed as nonprofit corporations. *See id.* § 1:03. This Article primarily addresses this and the other formal type of organization a charity may take, the charitable trust. *See id.* Charities can also be formed as unincorporated associations, but there is very little legal authority regarding such entities, which typically operate under agency principles. *See id.* Therefore, I leave this form aside for now.

7 *See* Janne Gallagher, *The Legal Structure of Property-Tax Exemption*, in *PROPERTY-TAX EXEMPTION FOR CHARITIES* 3, 4–6 (Evelyn Brody ed., 2002).

8 *See* I.R.C. § 501 (2006).

9 *Id.* § 501(c)(3).

10 *See, e.g., id.* § 170(c) (income tax deduction); *id.* § 2055 (estate tax deduction); *id.* § 2522 (gift tax deduction).

11 *See* *Regan v. Taxation with Representation of Wash.*, 461 U.S. 540, 544 (1983) (describing both deductibility and tax exemption as subsidies for charities' contributions to public welfare); *see also* Rob Atkinson, *Altruism in Nonprofit Organizations*, 31 B.C. L. REV. 501, 605–06, 606 n.292 (1990) (describing the “traditional subsidy theory of the tax exemption for altruistic nonprofits” and cataloguing statements of courts and commentators on this theory); Miranda Perry Fleischer, *Theorizing the Charitable*

essarily including forceful statements on what is a charity. In large part, I share this view of the deductibility regime. Like other deductions, the charitable deduction is an expression of the government's decision about what activities to subsidize.¹² I view the exemption regimes under federal and state tax law, however, as quite different. These exemptions are basic expressions by our legal, political, and social systems about what types of entities are fully and truly charities. Likewise, they screen out those types of entities that, while perhaps deserving favor or praise for various reasons, are not charities. The charity category identifies entities it would be improper to subject to taxation, not merely those that the government might desire to subsidize.¹³ Thus, to reiterate, when this Article speaks of charity law, it refers both to state organizational law and federal and state tax exemption law as its critical sources.

A. *Other-Regarding Orientation*

The requirement that charities maintain an other-regarding orientation is ultimately a product of the basic tension between charity law's commitment to mission and its inability to adequately patrol that commitment.¹⁴ This principle says that a charity must direct itself

Tax Subsidies: The Role of Distributive Justice, 87 WASH. U. L. REV. 505, 517–28 (2010) (accepting the view that tax exemption and deductibility are both tax subsidies in a piece arguing for recognition that distributive justice plays a key role in explaining tax benefits for charities); Simon et al., *supra* note 3, at 274–76 (reviewing subsidy rationales for tax exemption and deductibility).

12 See David E. Pozen, *Remapping the Charitable Deduction*, 39 CONN. L. REV. 531, 552–53 (2006) (describing the widespread acceptance of “the deduction . . . as a government subsidy”).

13 See Evelyn Brody, *Of Sovereignty and Subsidy: Conceptualizing the Charity Tax Exemption*, 23 J. CORP. L. 585, 587–96 (1998) (articulating a “sovereignty perspective” on the tax benefits received by charity, arguing they derive from the treatment of charities as quasi-sovereigns). Notably, Brody cautions that a sovereignty approach to designing charitable tax benefits can both benefit and harm charities, as the government may enact rules in order to control or limit the rival, quasi-sovereign charity. See *id.* at 606. My view also shares some aspects with the “community interest” theory of charity tax benefits. See 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, 1083–84 (2007) [hereinafter Buckles, *Peep*]; Johnny Rex Buckles, *The Community Income Theory of the Charitable Contributions Deduction*, 80 IND. L.J. 947, 967–74 (2005) [hereinafter Buckles, *Community Income Theory*].

14 Brian Galle, *Keep Charity Charitable*, 88 TEX L. REV. 1213, 1219 (2010) (disputing the notion that a majority of the work currently done in the charitable sector ought to be farmed out to for-profit firms, based partially on the notion that such a step would compound the already vexing question of monitoring); Thomas L. Greaney & Kathleen M. Boozang, *Mission, Margin, and Trust in the Nonprofit Health*

toward a charitable class and provide the benefits of its success to them: not to donors, not to equity investors, not to leaders or managers, not even to unrelated parties if they are outside the benefitted class.¹⁵ While this essential principle does not identify the particular content that will comprise a charity's mission, it does mandate at least this very basic level of altruism. As noted above, society cannot monitor and police every activity or purpose that a charity might undertake; indeed, it would be undesirable for it to do so even if such regulation were possible.¹⁶ However, by mandating an other-regarding orientation, charity law sets the outside limits on the behavior in which charities may engage. When a charity's leaders forsake the pursuit of benefits for others and turn instead to accruing benefits for themselves, the entity veers off the permissible course and loses its entitlement to charity status.

For much of the last three decades, legal academics have recognized a single defining legal characteristic of charities: the nondistribution constraint.¹⁷ Charities may not distribute profits to

Care Enterprise, 5 YALE J. HEALTH POL'Y L. & ETHICS 1, 82–85 (2005) (describing the difficult accountability question posed by nonprofits as entities with multiple stakeholders and offering a “mission primacy” approach as a partial solution).

15 See Atkinson, *supra* note 11, at 566–99 (offering a view of the fundamental value of charities based on altruism); Ira Mark Ellman, *Another Theory of Nonprofit Corporations*, 80 MICH. L. REV. 999, 1021 n.51 (1982) (“It has been said that the core feature of charity is that it is not ‘self-regarding,’ but ‘other regarding.’”).

16 See Mayer, *supra* note 1, at 24 (discussing various potential “justification[s] for charity autonomy”); Smith, *supra* note 1, at 347–55 (noting the benefits charities enjoy as autonomous entities).

17 See, e.g., Rob Atkinson, *Unsettled Standing: Who (Else) Should Enforce the Duties of Charitable Fiduciaries?*, 23 J. CORP. L. 655, 665 (1998) (referring to the nondistribution constraint as the “defining feature” of nonprofits); John D. Colombo, *Federal and State Tax Exemption Policy, Medical Debt and Healthcare for the Poor*, 51 ST. LOUIS U. L.J. 433, 435 (2007) (referring to the nondistribution constraint as “the chief requirement” for nonprofit status); Deborah A. DeMott, *Self-Dealing Transactions in Nonprofit Corporations*, 59 BROOK. L. REV. 131, 132 (1993) (“The defining difference between a nonprofit and a for-profit corporation is the nondistribution constraint”); Daniel Halperin, *Income Taxation of Mutual Nonprofits*, 59 TAX L. REV. 133, 136 (2006) (noting the nondistribution constraint as the distinguishing feature of nonprofit, versus for-profit, entities); Geoffrey A. Manne, *Agency Costs and the Oversight of Charitable Organizations*, 1999 WIS. L. REV. 227, 230 (describing the nondistribution constraint as the “[t]he defining characteristic of a charitable nonprofit”); see also Usha Rodrigues, *Entity and Identity*, 60 EMORY L.J. (forthcoming 2011), available at <http://ssrn.com/abstract=1701285> (arguing that due to the nondistribution constraint, nonprofits can offer a unique kind of social identity benefit to their patrons, one that entities organized using other forms cannot provide).

individuals or entities maintaining control positions within them.¹⁸ By limiting its application to those with organizational control, the nondistribution constraint is a slightly more limited statement of the other-regarding orientation requirement. The core mandate that a charity reinvest its residual earnings in its mission to serve others, rather than route these earnings to individuals or entities outside its intended benefitted class, is the same. The nondistribution constraint, however, focuses on individuals with organizational control.

This nondistribution constraint and the broader other-regarding orientation requirement are strongly expressed by a plethora of legal rules: state organizational law barring self-dealing by fiduciaries and limiting distributions more generally; the restrictions on inurement, private benefit, and excess benefit transactions under federal tax exemption law; and the various tax, corporation, and trust law doctrines addressing charitable purpose and charitable class. This subpart offers a basic review of these rules, demonstrating the ways they embody the other-regarding orientation requirement.

State law bars unfair self-dealing by charity fiduciaries.¹⁹ More general prohibitions on distributions can also be found, some in state nonprofit corporation statutes. The Revised Model Nonprofit Corporation Act (RMNCA), on which many state statutes are based, provides a good example. It pointedly prohibits distributions,²⁰ defined as “the payment of a dividend or any part of the income or profit of a corporation to its members, directors or officers.”²¹ Directors and officers exercise organizational authority as fiduciaries. Statutory members, when they exist, also possess some organizational control. They must

18 See Hansmann, *supra* note 2, at 838 (“A nonprofit organization is, in essence, an organization that is barred from distributing its net earnings, if any, to individuals who exercise control over it, such as members, officers, directors, or trustees.”).

19 See MARION R. FREMONT-SMITH, *GOVERNING NONPROFIT ORGANIZATIONS* 195–99, 219–25 (2004); Harvey J. Goldschmid, *The Fiduciary Duties of Nonprofit Directors and Officers: Paradoxes, Problems, and Proposed Reforms*, 23 J. CORP. L. 631, 646 (1998).

20 See REVISED MODEL NONPROFIT CORP. ACT §§ 13.01–.02 (1987). Limited distributions are permitted by mutual benefit corporations, but these noncharitable nonprofits fall outside the scope of this Article. Note that references to the RMNCA herein indicate the 1987 version, which many jurisdictions have adopted. See FREMONT-SMITH, *supra* note 19, at 152 (reporting twenty-three adoptions in 2003). They do not refer to the recent product of the American Bar Association Section on Business Law, Committee on Nonprofit Organizations, entitled the Model Nonprofit Corporation Act, Third Edition. This more recent work makes substantial changes to the RMNCA to harmonize it with the Model Business Corporation Act. See Carter G. Bishop, *The Deontological Significance of Nonprofit Corporate Governance Standards: A Fiduciary Duty of Care Without a Remedy*, 57 CATH. U. L. REV. 701, 718 (2008).

21 REVISED MODEL NONPROFIT CORP. ACT § 1.40(10).

approve amendments to the articles of incorporation, mergers, and dissolutions and can initiate changes in ongoing organizational operations through bylaw amendments.²²

Federal tax law imposes an other-regarding orientation requirement by defining those entities eligible for charitable exemption as those in which “no part of the net earnings . . . inures to the benefit of any private shareholder or individual.”²³ Three important doctrines expand on this definitional limit: inurement, private benefit, and excess benefit. Inurement doctrine targets organizational insiders, banning those with control from receiving profits.²⁴ The companion private benefit doctrine prohibits substantial benefits accruing to any private individual not provided as part of the entity’s charitable activities.²⁵ Incidental benefits, presumably, are unavoidable and no cause for penalty.²⁶ In contrast, substantial benefits threaten to be favors for those with control or a diversion from the other-regarding mission of the organization.

Infringing either of these prohibitions carries the ultimate sanction: loss of exemption and exclusion from the charity category.²⁷ If applied, this sanction puts a charity whose controlling parties engaged in inurement out of business, deserting any charitable class the charity might have helped. Yet, it leaves untouched the individuals who were inappropriately benefitted.²⁸ The excess benefit statute and accompa-

22 See, e.g., REVISED MODEL NONPROFIT CORP. ACT §§ 10.03, 11.03, 12.02, 14.02 (requiring member approval in order for a nonprofit corporation to amend its articles, merge, sell all or substantially all of its assets, or dissolve); see also *id.* § 6.03 (noting that nonprofit corporations need not have members at all).

Members under relevant nonprofit corporate statutes are granted governance rights. It should be noted, however, that some charities use the term “member” to recognize the financial or other contributions of particular individuals or to build the organization’s connection to them. These “affinity members” have no governance rights and should be distinguished from statutory members. I thank Evelyn Brody for this clarifying term.

23 I.R.C. § 501(c)(3) (2006).

24 See FREMONT-SMITH, *supra* note 19, at 248–49; James J. Fishman, *Wrong Way Corrigan and Recent Developments in the Nonprofit Landscape: A Need for New Legal Approaches*, 76 FORDHAM L. REV. 567, 584–85 (2007).

25 See Simon et al., *supra* note 3, at 282–83 (describing the private benefit doctrine and comparing it with both inurement and excess benefit).

26 Terri Lynn Helge, *The Taxation of Cause-Related Marketing*, 85 CHI.-KENT L. REV. 883, 931 (2010) (“If an organization provides more than incidental private benefit, the organization’s tax-exempt status may be revoked.”).

27 FREMONT-SMITH, *supra* note 19, at 250.

28 See Helge, *supra* note 26, at 931–32 (discussing the potential ramifications of violation of these prohibitions and noting that these impacted only the charities themselves).

nying regulations better align available remedies with the aim of maintaining charities' other-regarding orientation. This regime imposes penalty taxes on individuals with control who engage in transactions with their charities, to the extent that such transactions result in the individuals' receipt of excessive benefits.²⁹ In addition, the benefitted party must make restitution.³⁰ The charity itself is made whole, not penalized with loss of status, and may go on pursuing its other-regarding mission. The expressive value of § 501(c)(3)'s limitation on the destination of net earnings³¹ and the message of these doctrines could not be clearer. An other-regarding orientation is an essential requirement for status as a charity under federal tax exemption law.

Many of the prohibitions on self-dealing and distributions epitomize the more specific nondistribution constraint, by limiting their application to those with control.³² Yet, when these are taken along with legal requirements addressing charitable class and purpose, the more general requirement of other-regarding orientation comes into view. For example, to create a charitable trust, its benefits must be dedicated to some broad class of beneficiaries.³³ This class of others must be benefitted by the trust, rather than the trustee, settlor, or a set of private beneficiaries of the settlor's largesse.³⁴ These alternative objects might be validly served by a private trust. The advantages of charitable status, including exemption from the rule against perpetuities and eligibility to pursue tax-favored status, are limited to those *charitable* trusts that form and operate in this other-regarding fashion.³⁵

Charitable purpose requirements, found in both state organizational and federal and state tax exemption law, also speak to other-regarding orientation. Federal tax exemption is limited to entities formed for "religious, charitable, scientific, testing for public safety, literary, or educational purposes," and a few other specialized pur-

29 See I.R.C. § 4958 (2006); Taxes on Excess Benefit Transactions, 26 C.F.R. § 53.4958-1 (2002); see also FREMONT-SMITH, *supra* note 19, at 252–64 (describing the excess benefit regime at length).

30 See FREMONT-SMITH, *supra* note 19, at 259.

31 I.R.C. § 501(c)(3).

32 See FREMONT-SMITH, *supra* note 19, at 248–49; see also Fishman, *supra* note 24, at 584.

33 See RESTATEMENT (THIRD) OF TRUSTS § 28 (2003); 15 AM. JUR. 2D *Charities* §§ 69, 106 (2000).

34 See RESTATEMENT (THIRD) OF TRUSTS § 28 cmt. g(2) ("[T]he rule against perpetuities is somewhat relaxed when charitable purposes are involved . . .").

35 See *id.* § 29.

poses.³⁶ State statutes also frequently describe the purposes for which charitable corporations may properly form. Some offer long lists of purposes that are appropriate, such as New York's which includes "civic, patriotic, political, social, fraternal, athletic, agricultural, horticultural, and animal husbandry"³⁷ purposes; others repeat (sometimes with slight variation) the federal exempt purposes categories; and some do both.³⁸ Those statutes based on the RMNCA require charitable corporations to declare themselves to be public benefit corporations or religious corporations.³⁹ To qualify as a public benefit corporation, an organization must either be deemed as such by state statute, be exempt under § 501(c)(3), or be "organized for a public or charitable purpose."⁴⁰ The statute defines neither "public" nor "charitable," but instead relies on the common law to determine their meaning in specific cases.⁴¹ Charitable trust law permits formation for a range of purposes, generally including relief of poverty, advancement of education, religion, health, and governmental, or municipal purposes, as well as a catchall category of "other purposes . . . beneficial to the community."⁴² State property tax exemptions granted by constitutional mandate or legislation are likewise varied in their descriptions of the exempt category, but often speak of "purely public charity" and educational or religious purposes.⁴³

The law has struggled to provide a conclusive definition of charitable purpose. This struggle will not be resolved by my identification of charity law's essentials here. Indeed, the search for a conclusive definition of charitable purpose is a fool's errand, as the bounds of charity must evolve over time in order to serve the changing needs of

36 I.R.C. § 501(c)(3). Although many of the purpose requirements cited here reference religious purposes, this Article sets aside religious organizations due to the special constitutional and religious law issues they raise.

37 N.Y. NOT-FOR-PROFIT CORP. LAW § 201 (McKinney 2005).

38 See FREMONT-SMITH, *supra* note 19, at 127.

39 REVISED MODEL NONPROFIT CORP. ACT § 17.07 (1987).

40 *Id.*

41 See FREMONT-SMITH, *supra* note 19, at 127.

42 The Uniform Trust Code (now adopted in twenty-one states and under consideration in three more) permits charitable trusts to be formed "for the relief of poverty, the advancement of education or religion, the promotion of health, governmental or municipal purposes, or other purposes the achievement of which is beneficial to the community." UNIFORM TRUST CODE § 405(a) (2005); see also FREMONT-SMITH, *supra* note 19, at 120 (offering a similar list and referencing, additionally, the Restatement (Third) of Trusts).

43 See Evelyn Brody, *All Charities Are Property-Tax Exempt, but Some Charities Are More Exempt than Others*, 44 NEW ENGL. L. REV. 621, 625-34 (2010); Gallagher, *supra* note 7, at 4-6.

society and the public. Yet, one can see the influence of the other-regarding orientation requirement in the core of the charity category that various legal sources stake out. In each of the descriptors chosen, one sees the idea of serving a greater or qualitatively different purpose than one's own self-regarding needs. Sometimes this is expressed with general notions of serving the public, or government purposes, or pursuing what is charitable, whatever that might be held to mean in a given time and context. Other times the description is more specific, such as pursuing education, a mission that will include the teaching of others or at least generating knowledge that could somehow serve the community. By its demands on charitable purpose, vague as they may be, the law expresses the idea that charity is appropriately directed toward enriching the lives of others rather than enriching oneself.

Significant portions of current charity law are taken up by embracing and expressing the other-regarding orientation requirement. A wide range of sources articulate the nondistribution constraint, as well as many other clear and forceful legal limitations on self-regarding activity. These are pivotal concepts, but they do not provide a sufficient prescription for how the law should define and limit the charity category. Charity law must also block access to charity status to single individuals or organizations controlled by a single individual, even if it effectively restrains such individuals' abilities to benefit personally from their organizations. It is to the contours of this other vital essential that I now turn.

B. Group Governance

Charity law should powerfully defend its mission imperative by requiring charities to use a strong group governance model. This essential principle says that while a business can be formed and governed individually, a charity fundamentally requires more than one person's desire to pursue some view of the good. A charity must be governed by a group.⁴⁴

Again, understanding that charities' accountability to mission must ultimately be self-policed is crucial to grasping the importance of group governance. A charity is an entity pursuing some mission that

⁴⁴ For an economic account of nonprofit entities keyed to this concept of a defined group, see Woods Bowman, DePaul Univ., Presentation to the 38th Annual Conference of the Association for Research on Nonprofit Organizations and Voluntary Action: What Is Nonprofit? The Nondistribution Constraint Revisited (Nov. 20, 2009) (on file with author). Bowman argues charities are defined by the combination of benefits being vested in a constituency *as a group* and control, albeit weak, by that group. See *id.* at 3 & fig.1.

is of value (or at least potential value) to society (or some segment of it). But, charity regulators cannot and should not vigorously police mission. Regulators' litigation and tax enforcement tools are ill suited to evaluating faithfulness to charitable missions. Moreover, reliance on public enforcement of charitable mission would seriously threaten charitable autonomy and perhaps infringe on associational rights.⁴⁵ Some internal method is required to encourage charities themselves to pursue a mission that will ultimately benefit society and to do so by appropriate means. This method is the dialogic process, among a group, whereby a charity formulates its mission and transforms this mission and its practices over time. No single person can be trusted to challenge the continuing benefit of an articulated mission. No individual can be counted on to sufficiently vet whether particular programs or activities appropriately serve it.⁴⁶ The model of individual governance simply does not offer a solution to the challenge of regulating charitable mission. The collaboration and dialogue required by a strong model of group governance is such a solution.⁴⁷

Current charity law occasionally gives voice to group governance norms. State nonprofit corporation law generally requires at least a three-member board of directors to govern an incorporated charity.⁴⁸

45 See Dana Brakman Reiser, *Enron.org: Why Sarbanes-Oxley Will Not Ensure Comprehensive Nonprofit Accountability*, 38 U.C. DAVIS L. REV. 205, 226–30 (2004).

46 Commentators have frequently noted the multiple constituencies inherent in charitable organizations. See, e.g., Evelyn Brody, *Agents Without Principals: The Economic Convergence of the Nonprofit and For-Profit Organizational Forms*, 40 N.Y.L. SCH. L. REV. 457, 519–35 (1996); Evelyn Brody, *The Board of Nonprofit Organizations: Puzzling Through the Gaps Between Law and Practice*, 76 FORDHAM L. REV. 521, 526–27 (2007); Greaney & Boozang, *supra* note 14, at 82–84.

47 See Norman I. Silber, *Anticonsultative Trends in Nonprofit Governance*, 86 OR. L. REV. 65, 97 (2007) (criticizing the trend away from “consultative” or “collaborative” governance models as potentially impoverishing both the governance and mission achievement of individual charities as well as contributing to a loss of social capital); see also Mark Bovens, *Analysing and Assessing Public Accountability* 9 (European Governance Paper No. C-06-01, 2006), available at <http://www.connex-network.org/eurogov/pdf/egp-connex-C-06-01.pdf> (describing “public accountability” as “a relationship between an actor and a forum, in which the actor has an obligation to explain and justify his or her conduct, the forum can pose questions and pass judgment, and the actor may face consequences” (emphasis omitted)); Edmund Douglas Hayward Flack, *The Role of Annual Reports in a System of Accountability for Public Fundraising Charities* (Jan. 2007) (unpublished Ph.D. dissertation, Queensland University of Technology), available at http://eprints.qut.edu.au/16362/1/_Edmund_Flack_Thesis.pdf (adopting this forum-based accountability model in the charity context).

48 See, e.g., REVISED MODEL NONPROFIT CORP. ACT § 8.03 (1987) (requiring that a board of directors “must consist of three or more individuals”); Evelyn Brody, *Charity Governance: What's Trust Law Got to Do with It?*, 80 CHI.-KENT L. REV. 641, 645 (2005);

Further, boards of directors must act as a group, either by majority vote at a meeting in which a quorum is present or by unanimous written consent.⁴⁹ Although a few states permit a single director, this minority rule has been criticized.⁵⁰ In contrast, charitable trust law generally permits a settlor to appoint a single trustee,⁵¹ though again this structure has been criticized.⁵² Any future governance personnel changes can be provided by trust documents or filled in by courts as the need arises.⁵³ Trust law does offer settlors considerable freedom to alter the means of trust governance as they desire, and some settlors have established board-like governance for individual trusts.⁵⁴ This technique, however, is neither required nor customary. Even without adopting a board-like system, group governance remains the default rule in charitable trusts with more than one trustee, and they may act by majority decision.⁵⁵ Yet, trust law's flexible approach also allows settlors to allocate authority over particular roles or functions to a single trustee, which allocation may relieve cotrustees of responsibility for those functions.⁵⁶

Existing critiques of single fiduciary charities cite their vulnerability to fraud—by the actions of others or a fiduciary's own base motives.⁵⁷ Additionally, governance by a single individual leaves little opportunity for the vetting of decisions to ensure that they are efficient and wise.⁵⁸ More importantly here, though, the group govern-

see also UK CHARITY COMM'N, CHARITABLE COMPANIES: MODEL MEMORANDUM AND ARTICLES OF ASSOCIATION 17 (2009), *available at* <http://www.charity-commission.gov.uk/Library/guidance/gd1text.pdf> (requiring at least three directors).

49 *See, e.g.*, REVISED MODEL NONPROFIT CORP. ACT §§ 8.21, 8.24.

50 *See* PANEL ON THE NONPROFIT SECTOR, PRINCIPLES FOR GOOD GOVERNANCE AND ETHICAL PRACTICE 16 (2007), *available at* http://www.nonprofitpanel.org/Report/principles/principles_guide.pdf (noting, in a report produced in response to a Senate Finance Committee request, that a panel of experts had recommended that a minimum of five directors be required for an incorporated charity to qualify for federal tax exemption).

51 *See* Brody, *supra* note 48, at 645.

52 *See id.* at 672 (“[S]ingle-director and single-trusteed charities seem to invite failures of proper independence and protection of the public interest.”).

53 *See* RESTATEMENT (THIRD) OF TRUSTS § 34(2) (2003).

54 Stanford University is one well-known example of this trust governance alternative. *See Stanford Facts: Finances*, STAN. U., <http://www.stanford.edu/about/facts/finances.html> (last visited Jan. 7, 2011).

55 *See* RESTATEMENT (THIRD) OF TRUSTS §§ 39, 81. *See generally* Brody, *supra* note 48, at 663–65.

56 *See* RESTATEMENT (THIRD) OF TRUSTS § 81 cmt. b.

57 *See* PANEL ON THE NONPROFIT SECTOR, *supra* note 50, at 21–22; Brody, *supra* note 48, at 661–68.

58 *See* Brody, *supra* note 48, at 661–68.

ance concept maps onto concerns that charity not be enabled and ennobled to create a personal fiefdom, but rather to pursue some mission for the benefit of society. A charity governed by a single individual offers no proxy for articulating or monitoring the public or common good in whose name it is created and maintained.

The group governance norm is also subtly at work in those few state law provisions requiring independent directors. Five states specifically require a set percentage (usually a majority) of nonprofit corporate directors to qualify as independent.⁵⁹ The RMNCA includes such a requirement as an optional provision.⁶⁰ These requirements focus on and attempt to limit the familial or financial connections between a director and her charity and its other directors and leaders. For example, Maine permits no more than forty-nine percent of a charitable corporation's directors to be "financially interested persons," receiving compensation from the charity or having a close family relationship with someone who does.⁶¹ Such independence requirements in part respond to the concerns underlying the other-regarding orientation requirement. They seek to avoid financial conflicts whereby individuals personally benefit from the charity rather than directing its resources toward the good of others, or at least to preserve the charity's ability to manage such conflicts when they occur.⁶² The other major concerns underpinning independence requirements, however, are to ensure objectivity of board members and prevent domination by one or more interested individuals.⁶³ These concerns are linked to the need for group governance. A board with a true mix of members allows for genuine give-and-take on all topics, including questions of mission. A single dominant individual surrounding herself with relatives or cronies will not.

Of course, the group governance norm could be even more strongly embodied, such as by a requirement that charities have voting

59 See CAL. CORP. CODE § 5227(a) (West 2006); ME. REV. STAT. tit. 13-B, § 713-A(2) (2005); N.H. REV. STAT. ANN. § 292:6-a (2009); N.D. CENT. CODE § 10-33-27(2) (2005); VT. STAT. ANN. tit. 11B, § 8.13(a) (1997).

60 See REVISED MODEL NONPROFIT CORP. ACT § 8.13 (1987).

61 See ME. REV. STAT. tit. 13-B, § 713-A(2); see also, cf. REVISED MODEL NONPROFIT CORP. ACT § 8.13 (providing an optional provision with this language); N.H. REV. STAT. ANN. § 292:6-a (1999) (imposing a different independence requirement that charity boards be composed of at least five directors "who are not of the same immediate family or related by blood or marriage").

62 See Kathleen M. Boozang, *Does an Independent Board Improve Nonprofit Corporate Governance?*, 75 TENN. L. REV. 83, 99 (2007); Dana Brakman Reiser, *Director Independence in the Independent Sector*, 76 FORDHAM L. REV. 795, 807-09, 814-15 (2007).

63 See Boozang, *supra* note 62, at 99; Brakman Reiser, *supra* note 62, at 809-11, 814-15.

members as well as a representative and deliberative method of governance including them. Current charity law does not embrace this view. Instead, a voting member governance structure is optional for incorporated charities and, in practice, little used by them.⁶⁴ Even when charities do opt to empower a group of individuals as voting members, courts do not always hold them strictly to the structures required by their formative documents. This would empower the governing group by enforcing its role in the governance process. But when tested, courts have declined to reinforce group governance norms ardently.⁶⁵

In fact, the voting membership structure is most frequently encountered in a situation that undermines the group governance norm. Charities desiring to create parent-subsidiary relationships often establish the charity parent as the sole member of its subsidiary charity. This sole member's monopoly on voting rights allows it to elect the entire subsidiary board.⁶⁶ This sole voting member variant poses obvious problems for a robust idea of group governance. Despite the existence of a member and perhaps multiple nominal directors on the subsidiary's board, a single entity—the corporate parent—has all of the power. In sum, nonprofit organizational law and practice embracing the group governing norm is decidedly thin.

Federal tax exemption law is agnostic among the organizational forms qualifying charities might take, and likewise takes no strong position on exempt organizations' commitment to group governance. A § 501(c)(3) tax-exempt entity may be a "corporation (or unincorporated association), community chest, fund, or foundation."⁶⁷ These state forms require only the bare level of group governance described above.⁶⁸ A few years ago, a congressional committee's staff considered requiring incorporated exempt charities to have at least three directors, a majority of whom were independent.⁶⁹ The proposals were not

64 See FREMONT-SMITH, *supra* note 19, at 159. Even in groups with a nominal number of voting members, these individuals are often the same individuals who serve as directors. See *id.*

65 See Dana Brakman Reiser, *Nonprofit Takeovers: Regulating the Market for Mission Control*, 2006 BYU L. REV. 1181, 1231–45 (describing and critiquing court enforcement of member voting processes).

66 See Dana Brakman Reiser, *Decision-Makers Without Duties: Defining the Duties of Parent Corporations Acting as Sole Corporate Members in Nonprofit Health Care Systems*, 53 RUTGERS L. REV. 979, 1005–09 (2001).

67 I.R.C. § 501(c)(3) (2006).

68 See, e.g., REVISED MODEL NONPROFIT CORP. ACT § 8.03 (1987) (requiring only that a board consist of at least three members).

69 See STAFF OF S. FIN. COMM., 108TH CONG., TAX EXEMPT GOVERNANCE PROPOSALS (Discussion Draft 2004).

adopted, but the IRS's recent guidance on good governance for charities does include recommendations that charities consider the perils of small boards and the desirability of independence.⁷⁰ Additionally, the newly revised Form 990, the principal charity tax reporting form, now inquires as to the number and independence of the members of a charity's governing body.⁷¹ These developments express support for the group governance norm, but fall short of mandating it.

State law extends its property tax exemption only to organizations that qualify as charities, using the organizational forms already addressed and incorporating their limited group governance demands.⁷² Other than this, state property tax exemption law does not speak to group governance.

Current charity law makes far too weak a commitment to group governance. The trust form allows charities to avoid group governance altogether. Even where a norm of group governance is articulated, as in nonprofit corporate law, the group required need not be large, nor must it be particularly diverse or democratically governed. Federal and state tax exemption law incorporate these requirements and federal law has made some gestures toward a stronger commitment. In order for charity law to effectively defend the mission imperative, it must be augmented to more fully and energetically commit to group governance.

C. *Anticommerciality*

In contrast, current charity law is cluttered with restrictions on categories of charities' activities. Current charity law constrains commercial activity even if the profits it generates are fully committed to reinvestment in charitable mission. It also restricts political activity even when undertaken in service of a charitable class. These limitations are so substantial and so complex as to suggest that avoiding commercial and political activities is likewise essential to safeguarding charities' missions. This subpart and the next take up the commercial and political limitations in turn, identifying the current charity law

⁷⁰ See *Governance and Related Topics—501(c)(3) Organizations*, IRS.Gov, 3 (2007), http://www.irs.gov/pub/irs-tege/governance_practices.pdf. For a critique of the IRS's charity governance initiative, see James J. Fishman, *Stealth Preemption: The IRS's Nonprofit Corporate Governance Initiative*, 29 VA. TAX REV. 545 (2010).

⁷¹ See I.R.S. Form 990, Return of Organization Exempt from Income Tax, Part VI (OMB No. 1545-0047) (2009), available at <http://www.irs.gov/pub/irs-pdf/f990.pdf> (setting forth a full page of questions related to the entity's governing body management policies and public disclosures).

⁷² See Gallagher, *supra* note 7, at 3–4.

embodying them and revealing their tenuous links to mission accountability.

Charities may and do conduct commercial activities, both related and unrelated to their missions. Indeed, the scope of the commercial activities in which charities engage is large and growing.⁷³ State organizational law imposes few restrictions on these activities. Occasional state nonprofit corporation statutes limit charities' conduct of commercial activities, though most permit such activities outright.⁷⁴ Charitable trust law likewise takes a permissive tone, setting no general limitations on charitable trusts' pursuit of commercial activities, though it tends not to speak specifically to the desirability of charitable trustees running businesses.⁷⁵ Thus, organizations may adopt the legal forms used by charities with little concern regarding their commercial activities.⁷⁶

In contrast, qualifying for state property and federal income tax advantages will subject a charity's commercial activities to significant scrutiny.⁷⁷ Property tax exemption is often founded on state constitutional provisions exempting property belonging to charities, public charities, or institutions of purely public charity.⁷⁸ In addition, jurisdictions require property to be used solely for such purposes; exemp-

73 See Elizabeth T. Boris & C. Eugene Steurle, *Scope and Dimensions of the Nonprofit Sector*, in THE NONPROFIT SECTOR RESEARCH HANDBOOK, *supra* note 3, at 66, 74–76 & tbl.3.6 (describing and tabulating the considerable share of nonprofit revenues generated from fees for services); Dennis R. Young & Lester M. Salamon, *Commercialization, Social Ventures, and For-Profit Competition*, in THE STATE OF NONPROFIT AMERICA 423, 430–36 (Lester M. Salamon ed., 2002) (cataloguing the nonprofit sector's "growing reliance on earned income" as well as the trend of nonprofits "integrating the market into the pursuit of their social missions in a more fundamental way"); Burton A. Weisbrod, *The Nonprofit Mission and Its Financing: Growing Links Between Nonprofits and the Rest of the Economy*, in TO PROFIT OR NOT TO PROFIT 1, 16 (Burton A. Weisbrod ed., 1998) (describing the increasing dependence of nonprofits on revenues from commercial activities) [hereinafter Weisbrod, *The Nonprofit Mission*]; Burton A. Weisbrod, *The Pitfalls of Profits*, STAN. SOC. INNOVATION REV., Winter 2004, at '40, 43 [hereinafter Weisbrod, *Pitfalls*].

74 REVISED MODEL NONPROFIT CORP. ACT §§ 3.01(a), 3.02(16-d) (1987) (setting the default purpose of nonprofit corporations as "[to] engag[e] in any lawful activity" and empowering them "to carry on a business").

75 UNIFORM TRUST CODE § 404 (2005) (requiring charitable trusts to pursue purposes that are "lawful, not contrary to public policy, and possible to achieve" and noting an intention to encourage third parties to engage in commercial transactions with trustees).

76 See Evelyn Brody, *Business Activities of Nonprofit Organizations*, in NONPROFITS & BUSINESS 83, 84 (Joseph J. Cordes & C. Eugene Steurle eds., 2008) ("Nonprofit corporation law has surprisingly little to say about business activity as such.").

77 See *id.*

78 See Gallagher, *supra* note 7, at 10.

tions for property owned by charities but not used for charitable purposes can be refused, revoked, or apportioned.⁷⁹ Furthermore, the conduct of commercial activities, particularly unrelated businesses, can limit or scuttle exemption despite an organization's otherwise charitable purposes.⁸⁰

Many states use a multifactor test to determine eligibility for property tax exemption.⁸¹ The factors differ across jurisdictions somewhat, but two frequent factors bear directly on charities' commercial activity. First, these tests exclude property operated for profit, reserving special scrutiny for those entities supported by fees charged for their services.⁸² Second, a few tests explicitly consider whether a charity seeking property tax exemption competes with for-profit businesses.⁸³ Using these and other rationales, a wide range of states have mounted challenges to property tax exemption for property used for nursing homes and retirement centers, day care centers, and, most prevalently, hospitals and other healthcare activities.⁸⁴ Such challenges often complain that the entity in question charges market rates for services, with some noting that they are "indistinguishable" from commercial entities.⁸⁵

Many of these challenges are also tied to concerns about the level of free care provided and whether the entities in question in fact lessen the burdens to be borne by government.⁸⁶ While not directly turning on the question of whether or not an entity is engaged in commercial activities, these questions do look to a sense of difference.

79 See *id.* at 7–10.

80 See John D. Colombo, *Reforming Internal Revenue Code Provisions on Commercial Activities by Charities*, 76 *FORDHAM L. REV.* 667, 670–72 (2007).

81 See Brody, *supra* note 43, at 625–32, app. at 671–732; Evelyn Brody, *The States' Growing Use of a Quid-Pro-Quo Rationale for the Charity Property-Tax Exemption*, 56 *EXEMPT ORG. TAX REV.* 269, 275–76 (2007); Gallagher, *supra* note 7, at 11.

82 See Brody, *supra* note 81, at 277–79 (collecting cases applying a prohibition on high user fees for entities qualifying for the charity property tax exemption).

83 See *id.* (collecting cases from various states and noting that "[t]he existence of for-profit competitors is generally not enough to render property taxable, although courts do consider competition a factor").

84 See Brody, *supra* note 81, at 279–83; Gallagher, *supra* note 7, at 12–14.

85 See, e.g., *Surtees v. Carlton Cove, Inc.*, 974 So. 2d 1013, 1017 (Ala. Civ. App. 2007); *Presbyterian Residence Ctr. Corp. v. Wagner*, 411 N.Y.S.2d 765, 767 (App. Div. 1978). In *Under the Rainbow Child Care Center, Inc. v. County of Goodhue*, 741 N.W.2d 880, 892–96 (Minn. 2007), the court made explicit findings that a child care center providing its services at or above market rates and with no provision for free care was properly denied property tax exemption. The case was, however, significantly undermined by a subsequent statute allowing applicants for property tax exemption to provide justification for a lack of free services. See Brody, *supra* note 43, at 632.

86 See Brody, *supra* note 43, at 645–54; Brody, *supra* note 81, at 276–77.

This dichotomy bolsters the concept that charity must be something qualitatively distinct from commercial activity, perhaps by providing some of its services *gratis* or by engaging in quasi-governmental activity that businesses would presumably shun. Throughout state property tax exemption law, the skepticism around commercial activity by charities is prominent, relevant, and sometimes determinative.

Federal tax exemption law further reflects the fundamental suspicion regarding charities' commercial activity in at least two sets of doctrine. Entities found to be overly "commercial" will be ineligible for exemption as charities.⁸⁷ In addition, the unrelated business income tax (UBIT) taxes income generated from unrelated business activities at the highest corporate or trust rate.⁸⁸ Much of this area of law is murky; indeed, it has become a commonplace to describe it as such.⁸⁹ Yet, it is worth reviewing to reveal its anticommmerciality bent.

Although outright prohibition of commercial activity can be found,⁹⁰ federal tax law concerns itself mostly with the extent of this activity and its nexus with an entity's exempt purposes—tax law's term for permissible charitable missions.⁹¹ Regulations allow for exemption despite a charity's operation of 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 purposes and if the organization is not organized or operated for the primary purpose of carry-

87 See BRUCE R. HOPKINS, *THE LAW OF TAX-EXEMPT ORGANIZATIONS* § 25.1-.2 (7th ed. 1998); Colombo, *supra* note 80, at 669-79 (summarizing current tax rules on commerciality); Hill, *supra* note 4, at 695-700 (same); see also FREMONT-SMITH, *supra* note 19, at 247-48 (noting that the so-called "commerciality doctrine" was "extrapolated from cases upholding the Service's denial of exemption on the basis that the operation of the charity in question was more in the nature of a commercial business operating in competition with for-profit companies," rather than expressed in the Internal Revenue Code).

88 See I.R.C. § 511 (2006). Tax rules also address how related entities will be treated for exemption and UBIT purposes. These rules, generally not created specifically for the exemption context, have created incentives for charities to create complex structures in order to maximize exemption and minimize tax payments due. See Colombo, *supra* note 80, at 679-80; see also Douglas M. Mancino, McDermott Will & Emery LLP, Presentation at the Architecture of Charities' Commercial Activities Conference: Structural Relations: Basic Structures 15-65 (2008) (on file with author); Stephen Schwarz, Presentation at the Architecture of Charities' Commercial Activities Conference: Managing Complex Structures 3-31 (2008) (on file with author).

89 See JAMES J. FISHMAN & STEPHEN SCHWARZ, *NONPROFIT ORGANIZATIONS* 596 (3d ed. 2006) (summarizing these concerns with the characterization of this doctrine as "untidy").

90 See Treas. Reg. § 1.501(c)(3)-1(b)(1)(iii) (2005) (using "a manufacturing business" as an example of nonexempt activity precluding exemption).

91 See *id.* § 1.501(c)(3)-1(e)(1).

ing on an unrelated trade or business.⁹² Further, the regulations explain that it is relevant to compare “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.”⁹³ This would appear to allow commercial activities, so long as they are insubstantial in comparison to exempt activities, and even substantial commercial activities, so long as they are in furtherance of exempt purposes. Substantial commercial activities not in furtherance of exempt purposes, however, raise the specter of a primary nonexempt purpose and jeopardize exemption.⁹⁴

Practically, though, the IRS and the courts tend to focus instead on how a charity conducts its commercial operations and whether this manner of operation appears similar to that of a for-profit.⁹⁵ A charity takes on an impermissible “commercial hue” when it uses a commercial pricing structure, selects products for their market appeal, advertises to a mass market, etc.⁹⁶ The size of the charity’s profits is also often relevant. Too much income from commercial activity, especially relative to expenditures on charitable activities, endangers exemption.⁹⁷ Neither of these strains of analysis directly focuses on whether commercial activity is “in furtherance of exempt purposes” and even this general summary suggests more consistency than one finds in regulatory and judicial rulings.⁹⁸

Federal tax law also hampers charities’ unrelated commercial activity even when it is not sufficiently substantial to exclude an entity from the charity category altogether. Rather than prohibiting or limiting this behavior outright, the UBIT taxes income derived from it. UBIT taxes income generated by a “trade or business.”⁹⁹ Almost anything done for income will qualify, and the regulations define trade or

92 *See id.*

93 *See id.*

94 *See* Schwarz, *supra* note 88, at 10–11 (noting this “conventional wisdom”).

95 *See* Brody, *supra* note 76, at 93 (“Case law tends to support the perhaps unfortunate result that nonprofits are often punished for efficient commercial operations.”).

96 *See* HOPKINS, *supra* note 87, at 77–82; Brody, *supra* note 76, at 93–95; Colombo, *supra* note 80, at 675–79.

97 *See* HOPKINS, *supra* note 87, at 80–82; Brody, *supra* note 76, at 93–95; Colombo, *supra* note 80, at 675–76.

98 *See* Colombo, *supra* note 80, at 675 (“[T]he case law has evolved into asking whether a particular activity has a commercial hue, and if so, whether it is substantial. Positive answers to these questions generally lead to loss of tax exemption, though even here the analysis is variable.”).

99 *See* I.R.C. § 511 (2006).

business activities narrowly.¹⁰⁰ Therefore, when sales are made to distinct groups or of distinct products, or an entity sells advertising within a related publication, each is treated as a separate trade or business activity under UBIT. The activity must also be “regularly carried on,”¹⁰¹ defined as frequent and continuous as compared with the conduct of the activity in its usual course.¹⁰² Finally, the activity must not be “substantially related to [the charity’s] exempt purposes.”¹⁰³ Substantial relationship depends on whether an activity “contributes importantly” to the accomplishment of exempt purposes.¹⁰⁴ This test is one of facts and circumstances, but the activity’s size, extent, and potential to compete with commercial firms are all important factors.¹⁰⁵

Various exceptions limit UBIT’s application,¹⁰⁶ and a UBIT-paying charity may take all of the deductions that would otherwise be available to a taxable entity paying tax on the relevant income.¹⁰⁷ As a result of the sophisticated use of exceptions, deductions, and separate entities, and perhaps charities’ fears about entering commercial ventures due to exemption risk, the UBIT collects relatively little revenue.¹⁰⁸ Yet, its message remains obvious: commercial activity is suspect and charities who engage in it will be subject to scrutiny and doubt.¹⁰⁹

100 See Treas. Reg. § 1.513-1(b) (2005) (defining a trade or business as “any activity carried on for the production of income from the sale of goods or performance of services”).

101 See I.R.C. § 512.

102 See Treas. Reg. § 1.513-1(c). For example, a summertime ice cream shop at a community center will be carried on regularly, whereas a sundae-selling event once a year will not.

103 I.R.C. § 513.

104 See Treas. Reg. § 1.513-1(d)(1)–(2).

105 See *id.*

106 See I.R.C. § 512(b); I.R.C. § 513(d)–(j). For a more detailed discussion of the UBIT, see FREMONT-SMITH, *supra* note 19, at 289–95, and Brody, *supra* note 76, at 96–100.

107 See I.R.C. § 511(a)(1).

108 See FREMONT-SMITH, *supra* note 19, at 295 (reporting the consensus of the conferees attending a 1999 meeting “that UBIT has in effect ‘become a voluntary tax’”); Grant Williams, *Many Charities Avoid Business-Income Tax*, CHRON. PHILANTHROPY, Apr. 23, 2009, at 27 (reporting studies that show that only forty percent of charities reporting receiving UBI in 2005 paid any tax on it and that fifty-one percent of charities in a 2008 study listed their UBIT as zero following deductions and other calculations).

109 See Brody, *supra* note 76, at 113 (mentioning UBIT’s “symbolic value to policy-makers and the public”); Ethan G. Stone, *Adhering to the Old Line: Uncovering the History and the Political Function of the Unrelated Business Income Tax*, 54 EMORY L.J. 1478, 1544 (2005) (proposing the purpose of UBIT is to “deter[] charities from engaging in activities that look bad”).

Current charity law is not as strident about charities' commercial activities as it is about self-regarding ones. It says commercial activities are suspect, not forbidden. Yet, the law speaks volumes on the subject, evaluating gradations of acceptable activity and imposing measured penalties. Despite the complexity and sometimes confusion of this body of law, it articulates a strong distrust of charities' commercial activities, whatever the use of the funds they generate. This message might lead one to believe an anticommmerciality position is essential to charity law.

The question remains, however, whether charity law's focus on identifying and restricting commercial activities is indeed necessary to enforce its mission imperative. Society wants charities to focus on their missions so they can generate the societal gains for which they are prized and privileged. When a charity engages in commercial activities, concerns arise that this focus and these gains could be lost. First, there is the diversion concern.¹¹⁰ If the charity and its leaders begin engaging in commercial activities, perhaps they will become distracted from their core mission and overly involved with the entity's business activities.¹¹¹ A community theater that opens a coffee house to enhance its revenue stream might lose track of its cultural mission while embroiled in the day-to-day operations of the business. When the commercial activity is an inherent part of a group's charitable mission, such as with schools that sell education services or hospitals that sell health care, the diversion concern is subtler. Individual product lines that compete with for-profit providers or are offered to students or patients paying market rates may be launched to generate revenue to subsidize mission-related programs. Yet, these activities could possibly capture leaders' attention and distract them from goals and activities closer to the core of a charity's mission.¹¹²

110 See John D. Colombo, *Commercial Activity and Charitable Tax Exemption*, 44 WM. & MARY L. REV. 487, 534–44 (2002) (describing the diversion concern and the related concern that commercial activities might signal a charity does not deserve various tax benefits); see also Hill, *supra* note 4, at 700–01 (arguing for a new tax regime imposing a “nondiversion constraint” to limit the use of exempt resources for nonexempt purposes, including commercial and political activities).

111 See SEEDCO POLICY CTR., *THE LIMITS OF SOCIAL ENTERPRISE* 7 (2007), available at <http://www.seedco.org/download/?id=10>; Colombo, *supra* note 110, at 534–35; Weisbrod, *Pitfalls*, *supra* note 73, at 44.

112 See Mayer, *supra* note 1, at 57 (noting this concern, and offering the insight that this diversion may not be due to the bad faith of charity fiduciaries, but merely due to the irresistible influence of its consumers).

In each case, of course, the converse could also be true: the commercial activities could reinforce the charity's pursuit of its mission.¹¹³ The coffee house could raise needed revenue to allow the theater group to mount more or move ambitious productions or to reduce ticket prices to encourage a more socioeconomically diverse audience. It could even draw new artists and theatergoers through the theater's doors. Schools' and hospitals' market product lines could likewise subsidize their less profitable teaching and healing activities, improve the skills of their faculties and physicians, or spread the word about their core mission offerings to a wider community. Current charity law restricting commercial activities is, if anything, an imperfect proxy for addressing the mission question that charities can best answer for themselves.

A second concern about charities' commercial activities also casts charity law's limits on commerciality in this proxy role. This concern suggests that commercial businesses that do not generate the social goods expected of charities could elide the relatively lax enforcement apparatus and thereby improperly obtain benefits intended only for charities. They would be "for-profit[s] in disguise."¹¹⁴ This would inappropriately drain the public fisc, reducing societal resources without obtaining the social returns that expenditures on true charities produce.¹¹⁵ It also could result in reputational costs for true charities, as the public would become less trusting that charities are beneficial to society and deserving of the benefits that they enjoy.¹¹⁶ Again, current charity law warns against commercial activities and limits and penalizes them when they are undertaken as a messy proxy for arresting mission-threatening activities.

Under current charity law, commercial activities raise a red flag as to whether a charity is truly focused on its charitable mission or has become at best distracted, and at worst, a front for a business enterprise. Commercial activity is easier for regulators to observe and superficially appears more appropriate for them to regulate than the harder questions of whether a charity has veered from its legitimate mission. But, ultimately, it is the mission question that charity law should care about. The anticommerciality position articulated by current charity law chills potentially useful activity, as well as each charity's own dialogue about how best to pursue its mission.

113 See J. Gregory Dees, *Enterprising Nonprofits*, HARV. BUS. REV., Jan.-Feb. 1998, at 55-67.

114 See BURTON A. WEISBROD, *THE NONPROFIT ECONOMY* 11 (1988).

115 See *id.* at 11-13; Colombo, *supra* note 110, at 532-34.

116 See WEISBROD, *supra* note 114, at 13-14.

D. *Limitations on Political Activities*

Like the anticommmerciality thread in current charity law, a significant body of cases, statutes, and regulations devote themselves to restricting charities' involvement in the political process. Federal tax law takes a fairly prophylactic approach. Section 501(c)(3) admits to exempt status only charities for which "influencing legislation" is "no substantial part" of their activities.¹¹⁷ Regulations do not offer a measure of substantiality,¹¹⁸ but the few cases addressing the topic suggest a fairly low ceiling.¹¹⁹ The chilling effect of this uncertainty leads some charities to elect a series of optional and complex, but more quantifiable, restrictions.¹²⁰ These restrictions require lobbying expenditures to be maintained below a maximum twenty percent of the entity's operating budget.¹²¹ Private foundations, which are generally charities with a small group of funders, are not permitted to engage in any lobbying whatsoever.¹²² In addition to the lobbying limits, all categories of federally exempt charity are banned from political campaign activity.¹²³ The IRS will apply penalty taxes or revoke a charity's exempt status for supporting or opposing candidates.¹²⁴

117 I.R.C. § 501(c)(3) (2006).

118 See generally *Developments in the Law: Nonprofit Corporations*, 105 HARV. L. REV. 1578, 1662 (1992) (emphasizing that neither the IRS nor the courts have determined what percentage of its income a nonprofit corporation may spend on lobbying before its efforts will be deemed "substantial").

119 See, e.g., *Seasongood v. Comm'r*, 227 F.2d 907, 912 (6th Cir. 1955) (holding less than five percent of political activity not to be substantial); *Haswell v. United States*, 500 F.2d 1133, 1142 (Ct. Cl. 1974) (eschewing a percentage rule, but finding an organization with political actions comprising approximately twenty percent of its activity ineligible to receive tax deductible contributions).

120 See Oliver A. Houck, *On the Limits of Charity: Lobbying, Litigation, and Electoral Politics by Charitable Organizations Under the Internal Revenue Code and Related Laws*, 69 BROOK. L. REV. 1, 62-67 & n.379 (2003) (noting groups' claims that the "no substantial part" test chilled lobbying made in the hearings on the new regime).

121 See I.R.C. § 4911(c)(2). The statute imposes a sliding scale, permitting lobbying expenditures up to twenty percent of an organization's exempt purpose expenditures, provided these are \$500,000 or less, and lower percentages of such expenditures as the overall budget rises. See *id.* Overages result in penalty taxes; repeat offenders can lose exemption. See Treas. Reg. § 1.501(h)-3 (2005).

122 See I.R.C. § 4945(d)(1) (subjecting any lobbying expenditures by a private foundation to prohibitive penalty taxes).

123 See *id.* § 501(c)(3) (stating that "no part of the net earnings of" a tax-exempt public charity may be used to "participate in, or intervene in . . . any political campaign on behalf of (or in opposition to) any candidate for public office").

124 See *id.* § 4955 (taxing campaign expenditures by any exempt organization); *id.* § 4945(d)(2) (subjecting campaign activity by a private foundation to additional prohibitive penalty taxes); see, e.g., *Branch Ministries v. Rossotti*, 211 F.3d 137, 141-42

As sweeping as the federal political limitations might seem, charities of sufficient size and sophistication can use a range of techniques to work around them. If an otherwise charitable entity wishes to engage in greater political activity than § 501(c)(3) will allow, it may form instead as a social welfare organization under § 501(c)(4).¹²⁵ Such an entity may attempt to influence legislation, so long as these attempts are germane to its social welfare purposes.¹²⁶ In fact, germane attempts to influence legislation may even be the primary purpose of an entity exempt under § 501(c)(4).¹²⁷ Status under § 501(c)(4) does not, however, throw open the door to unfettered involvement in politics. If political campaign activities become the primary activity of a § 501(c)(4) organization, it will no longer qualify for exemption under that section and will become partially subject to tax.¹²⁸ Status under § 501(c)(4) thus provides only limited exemption, and it does not authorize receipt of tax-deductible contributions.¹²⁹ Indeed, enforcing the prohibition on receiving such contributions may well be the major reason they are shunted into this lesser category. Relegating charities with substantial political activities to this different and less favored strongly expresses the conviction that charity and politics should remain distinct.

Of course, a sophisticated charity with political objectives may split into multiple entities to maximize both the tax advantages the charity can attain and the political activities in which it can engage. The split entities are then linked together to the extent permissible without jeopardizing this delicate balance. Dual structures, involving an exempt § 501(c)(3) organization and an affiliated entity organized under § 501(c)(4), permit more lobbying, but require extra administrative burdens to avoid commingling and to maintain overlapping boards.¹³⁰ Triad structures, which add a § 527 political organization, allow lobbying and campaign activities, but impose additional admin-

(D.C. Cir. 2000) (affirming IRS revocation of a church's exempt status due to campaign activities).

125 I.R.C. § 501(c)(4).

126 See I.R.S. Gen. Couns. Mem. 33,495 (Apr. 27, 1967).

127 See I.R.S. Gen. Couns. Mem. 34,212 (Oct. 22, 1969).

128 See Rev. Rul. 71-530, 1971-2 C.B. 237 ("The fact that the organization's only activities may involve advocating for changes in the law does not preclude the organization from qualifying under section 501(c)(4) of the Code."); I.R.C. § 527(f); Treas. Reg. § 1.501(c)(4)-1(a)(2)(ii) (2005).

129 See Treas. Reg. § 1.501(c)(4)-1(a)(2)(ii).

130 See Simon et al., *supra* note 3, at 285 (discussing this "sibling option"). The dual structure has been blessed, and some would say made constitutionally mandatory, by the U.S. Supreme Court in *Regan v. Taxation with Representation of Washington*, 461 U.S. 540 (1983), discussed *infra* note 283 and accompanying text.

istrative burdens because separate incorporation or banking is required, as is some significant distinction among boards.¹³¹ These complex structures permit a charity to maintain the most favored charity status under federal tax exemption law, while related entities engage in substantial political activity. Still, the burden of creating and maintaining affiliated structures is one that many charities cannot bear, and imposing it demonstrates again the disfavor charity law has for political activity.

State law instructing charities to eschew politics is more limited and varied. A few old precedents remain on the books branding such purposes outside the charitable category.¹³² Generally, though, state courts presented with the question have resolved that a nonprofit corporation or charitable trust may be formed with the partial or exclusive purpose of changing existing law.¹³³ Entities formed to promote political parties, however, are distinguished from those pursuing social causes the achievement of which would require a change in law, and are held not charitable.¹³⁴ Even if nonprofit corporate or charitable trust status will not be threatened by political purposes, qualification for state property tax exemption is another story. Although state statutes do not tend to call out political activities as a threat to property tax exemption, precedents in a variety of states assert that political activities will scuttle exemption for particular organizations or property uses.¹³⁵

131 See Simon et al., *supra* note 3, at 285 (describing this as a “double sibling structure” and noting its blessing in *Branch Ministries v. Rosotti*, 211 F.3d 137, 143 (D.C. Cir. 2000)).

132 See, e.g., *Workmen’s Circle Educ. Ctr. v. Bd. of Assessors*, 51 N.E.2d 313, 315–17 (Mass. 1943); *Bowditch v. Att’y Gen.*, 134 N.E. 796, 799 (Mass. 1922); *Jackson v. Phillips*, 96 Mass. (14 Allen) 539, 555 (1867). But see Elias Clark, *The Limitation on Political Activities: A Discordant Note in the Law of Charities*, 46 VA. L. REV. 439, 447–48 (1960) (discussing *Jackson* and similar cases and deeming them a dead letter nearly half a century ago).

133 See, e.g., *Register of Wills for Baltimore City v. Cook*, 216 A.2d 542, 549 (Md. 1966).

134 See RESTATEMENT (THIRD) OF TRUSTS § 28 cmt. 1 (2003); Laura Brown Chisolm, *Politics and Charity: A Proposal for Peaceful Coexistence*, 58 GEO. WASH. L. REV. 308, 345–47 (1990).

135 See, e.g., *In re Westboro Baptist Church*, 189 P.3d 535, 554 (Kan. Ct. App. 2008) (noting that “our Supreme Court has determined that political action or activities are not considered a religious activity” in affirming a denial of tax exemption for personal property owned by a religious group, but used for political purposes); see also, e.g., *New England Legal Found. v. City of Bos.*, 670 N.E.2d 152, 158–59 n.8 (Mass. 1996) (asserting that state law precludes tax exemption for organizations at some level of political activity); *Mich. United Conservation Clubs v. Twp. of Lansing*, 378 N.W.2d

A significant body of law expresses distaste for political activity by charities. Federal tax law imposes severe limitations based on it, though routes exist for some charities to partially avoid these restraints. State law is more equivocal. Engaging in politics will rarely block access to formation as a charity under state law. Still, property tax exemption may be threatened by such activities, and the overall concern about these activities somehow corrupting charities remains clear. Again, one might take from this reading the idea that eschewing politics is essential to protect charitable mission. Even without comprehensive and consistent prohibitions, charities have received the message that they should eschew politics. That message is loud and clear, and it chills charities' enthusiasm for engaging even in permitted political activities.¹³⁶ Yet, it remains debatable whether charity law needs to direct charities to avoid politics in order to safeguard the mission imperative.

The law directing charities to avoid politics seems inextricably tied to a quite cynical view of the political system as flawed and somewhat sinister. The fear here is that a charity that becomes enmeshed in politics, or does so to a significant degree, will be captured by its political patrons, to the detriment of its charitable mission.¹³⁷ Alternatively, of course, a charity might reasonably remain above the fray and yet see lobbying, appealing to the public to engage with the political system, or campaigning for candidates as vital components of pursuing its charitable mission. Regardless, current charity law warns charities to abstain from or limit political involvement, lest their leaders be diverted, their reputations sullied, or both.

Legal requirements limiting or prohibiting charities' involvement in political activity have been linked to other goals, of course. Perhaps the most common explanation for restricting charities' political activity is that government needs to remain neutral in the benefits it pro-

737, 743 n.6 (Mich. 1985) (“[C]ertain forms of lobbying may preclude a tax exemption.”).

136 See, e.g., Mark Chaves et al., *Does Government Funding Suppress Nonprofits' Political Activity?*, 69 AM. SOC. REV. 292, 297 (2004); Clark, *supra* note 132, at 452–54. Of course, not all charities are intimidated by these prohibitions, and some engage in prohibited activities regardless or in protest. See Eric Kelderman, *Churches Protest Politicking Ban*, CHRON. PHILANTHROPY, Oct. 16, 2008, at 13 (describing coordinated effort in 2008 presidential election).

137 See Donald B. Tobin, *Political Campaigning by Churches and Charities: Hazardous for 501(c)(3)s, Dangerous for Democracy*, 95 GEO. L.J. 1313, 1337–39 (2007); see also Buckles, *Peep*, *supra* note 13, at 1085–91 (describing this view critically); Laura B. Chisolm, *Exempt Organization Advocacy: Matching the Rules to the Rationales*, 63 IND. L.J. 201, 248 (1988) (same).

vides to charities.¹³⁸ This neutrality argument, however, is undermined by the ability of charities to engage in limited political activities and by government's apparent willingness to forego neutrality when granting businesses deductions for political activity.¹³⁹ Some have also raised concerns that expanding these benefits to politically active charities would generate an intolerable loss in tax revenue.¹⁴⁰ This argument posits that a concern for the diversion of government resources, and by extension taxpayer dollars, is the problem with charities' political activity, rather than the diversion of charity leaders.¹⁴¹ The argument, though, eventually leads back to concerns about charitable mission. If political activity is an appropriate action for charities, as relevant to their programs to feed the hungry, put on cultural events, or improve neighborhood relations, one should not worry that government resources are being expended on these activities. Indeed, the tax benefits for charities are intended to recognize the value of these contributions to society.

The political nature of lobbying and electioneering activities do not inherently pose risks to mission accountability. Political activities raise mission concerns when they lead charities to pursue purely private purposes or magnify the power of individuals within charities, while screening them from observation and regulation.¹⁴² Rather than attempting to determine whether charities have veered off course in such damaging ways, however, current charity law uses broad political restrictions as a slapdash proxy.

* * * *

138 See Buckles, *Community Interest Theory*, *supra* note 13, at 1079–85; Chisolm, *supra* note 134, at 249–52; Miriam Galston, *Lobbying and the Public Interest: Rethinking the Internal Revenue Code's Treatment of Legislative Activities*, 71 TEX. L. REV. 1269, 1286–1314 (1993).

139 See Chisolm, *supra* note 134, at 250–52; Galston, *supra* note 138, at 1286–1314.

140 See Clark, *supra* note 132, at 460–61. Another recent justification for the political restrictions explains them as necessary due to its vision of the charitable sector as the government's competitor. See Brian D. Galle, *Foundation or Empire? The Role of Charity in a Federal System* 58–61 (Jan. 5, 2010) (unpublished manuscript), available at <http://ssrn.com/abstract=1473107>.

141 See Clark, *supra* note 132, at 460–61.

142 See Buckles, *Peep*, *supra* note 13, at 1085–89; Mayer, *supra* note 1, at 34; see also David A. Brennen, *A Diversity Theory of Charitable Tax Exemption—Beyond Efficiency, Through Critical Race Theory, Toward Diversity*, 4 PITT. TAX REV. 1, 17 (2006) (arguing the purpose of tax law's political limitations, inter alia, is to “mediate between the private individual tendency for authoritative control and the public interests advanced by the charitable entity”).

The purpose of charity law is to focus charities and their leaders on the mission imperative. Current charity law partially, but not optimally, pursues this goal. It does forcefully demand that charities maintain an other-regarding orientation. Self-regarding activity, which uses the charity to provide benefits to its leaders or other private individuals outside the class benefitted by its charitable mission, should continue to disqualify an entity from charitable status. In contrast, current charity law demonstrates only a weak commitment to group governance. A charity must be composed of and governed by a diverse group, rather than by a single individual, in order to provide a means for monitoring and evolving charitable mission. Therefore, charity law should be revised to more consistently embrace a strong group governance norm. Current charity law's attempts to define and limit charities' commercial and political activity at best operate as messy proxies for mission enforcement. These activities are not inherently destructive of mission, and chilling them may damage charities' autonomy and vitality. Thus, the commercial and political restrictions are ripe for relaxation or removal.

II. CHALLENGES TO THE ESSENTIALS

The constraints created by current charity law attempt to train the eyes of charity leaders on their missions. As with any constraint, however, they also impose real costs. They limit possible innovations in charity financing, working methods, and governance. Charity innovators are bumping up against these constraints, and challenging them in creative and interesting ways. Many of these challenges derive from the increasing trend toward blending charitable motivations with business methods. This Part will offer a series of examples of this sector-blending activity, suggest how these phenomena challenge current charity law, and address how charity law should respond to them. This review reinforces the notion that charity law embodying the other-regarding orientation requirement remains crucial and that charity law expressing the group governance requirement should be amplified. It also offers further support for easing the restrictions on charities' commercial and political activities.

A. *Self-Regarding Charity*

Several recent proposals and innovations would permit self-regarding behavior by charities. In one such ambitious proposal, Dan Palotta calls for a new model for charities to operate with a profit-

distribution motivation.¹⁴³ Charities should be permitted to raise capital by promising investors a financial return.¹⁴⁴ Palotta argues his reform will help charities raise crucial funding, beyond what donations, loans, and fees for services can provide.¹⁴⁵ First off, he argues, these existing sources simply do not provide enough total financing to fund the projects that the charitable sector can and should put forward.¹⁴⁶ Second, in his view, these funding sources come with inherent limitations on their use.¹⁴⁷ Donors tend to want their investments to be used to create programs immediately or to be placed in an endowment and left untouched.¹⁴⁸ Bank loans and tax-exempt bond financing are options, but loan officers will require collateral and will not lend to charities in order to support innovative new programs.¹⁴⁹ Fees for service are not available to all charities, by any means; they are a feasible source of income only to those charities who serve relatively wealthy beneficiaries with the ability to pay.¹⁵⁰ Investment capital, on the other hand, is a huge untapped resource charities can use to pursue innovation and take risks, limited only by what the market is willing to fund.¹⁵¹ Thus, Palotta argues equity capital can be used to fund innovation and risk-taking activities in a way that other sources of charity capital cannot.¹⁵²

Today, of course, charity law's other-regarding orientation requirement blocks this financing resource. Palotta argues this restriction should be removed to allow charities to seek equity investors and pay them for access to their capital.¹⁵³ In the absence of such changes (or until they happen), he suggests that entrepreneurs with charitable missions legally form their organizations as for-profit corporations to avoid these restrictions—as he did.¹⁵⁴

143 See DAN PALOTTA, *UNCHARITABLE 17* (2008).

144 See *id.* at 116–25. This proposal is part of Palotta's broader agenda of reform. Other items include expanding the magnitude and types of compensation nonprofits may pay, encouraging them to take greater risks and look to the long term, and encouraging them to engage in paid advertising. See *id.* at 47–116.

145 See *id.* at 117–18.

146 See *id.*

147 See *id.* at 118–20.

148 See *id.*

149 See *id.* at 122–24.

150 See *id.* at 120–23.

151 See *id.* at 121.

152 See *id.* at 123–24.

153 See *id.* at 124.

154 See *id.*

Where Palotta reasons from experience, law professors Anup Malani and Eric Posner use economic analysis.¹⁵⁵ They, too, contest the need to restrict charities from utilizing equity capital. In a challenge to federal tax law's expression of the other-regarding orientation requirement, they argue that the right to tax exemption should be uncoupled from the nonprofit form and its nondistribution constraint.¹⁵⁶ Rather, when for-profit entities engage in socially beneficial activities, they too should be eligible for tax benefits currently reserved only for nonprofit charities.¹⁵⁷ Malani and Posner take issue with various arguments that might justify coupling. They argue that if tax subsidies are useful to augment the production of public goods, these subsidies should be made available to any entity that produces public goods, regardless of their nonprofit or for-profit form.¹⁵⁸ Likewise, they argue that the nondistribution constraint is not necessary to solve the agency problems that arise in producing charitable goods or services, and assert that it will often be ineffective in doing so.¹⁵⁹ Further, Malani and Posner claim that, at least outside the case of true public goods, encouraging altruists to produce charitable goods and services will often result in inefficient overproduction.¹⁶⁰ Finding each of these justifications wanting, they argue that any government subsidization of community benefit activities available to nonprofits should be made equally available to subsidize such activities by for-profits.¹⁶¹

155 See Anup Malani & Eric A. Posner, *The Case for For-Profit Charities*, 93 VA. L. REV. 2017 (2007).

156 See *id.* at 2064–65.

157 See *id.*

158 See *id.* at 2029–31.

159 See *id.* at 2031–39.

160 See *id.* at 2042–50. The authors also dispatch with the idea that coupling protects consumers suffering from inadequate information about the producers of charitable goods or avoids the administrative burden that policing tax benefits of for-profits would create for the IRS. See *id.* at 2050–54. They suggest that enforcement of consumer protection laws should be sufficient to deal with the former problem and user fees could offset the impact of the latter. See *id.*

161 Of course, these ideas have not gone without challenge. Victor Fleischer noted the significant regulatory challenges involved in executing Malani and Posner's proposal. See Victor Fleischer, "For Profit Charity": Not Quite Ready for Prime Time, 93 VA. L. REV. IN BRIEF 231, 232 (2008), <http://www.virginialawreview.org/inbrief/2008/01/21/fleischer.pdf>. Brian Galle argues "[f]or-profit charity threatens to shift costs to charities, weaken the warm glow of giving, distort managerial incentives, and diminish or confuse donor choice." Galle, *supra* note 14, at 1233. Usha Rodrigues argues for-profit firms cannot offer the same identity benefits to their patrons as can nonprofits. See Rodrigues, *supra* note 17, manuscript at 35.

These proposals do not exist solely in the realm of theory. Even without the carrot of tax breaks, Google Inc. took up the idea of pursuing charitable endeavors by for-profit means. It formed Google.org, the philanthropic arm to which it devoted one percent of the company's equity and profits, as a division of for-profit Google Inc.¹⁶² Although the company originally founded a traditional nonprofit, tax-exempt foundation to pursue its philanthropic vision, it soon found charity law's restrictions on this mode of operations too constraining.¹⁶³ It moved its philanthropy in-house, within its profit-generating and profit-distributing public company. As such, Google.org then began directly investing in companies and projects in line with its conservation, public health, and poverty reduction mission.¹⁶⁴ If these investments generate returns, the returns would go to Google itself and would be, at least in theory, available for distribution to the company's shareholders.¹⁶⁵ However, even Google.org's founders do not appear to support a complete reversal in the commitment to the other-regarding orientation requirement. While its for-profit philanthropy model would permit equity returns from its charitable activities, Google.org leaders fervently claimed that any such gains would

For an economics-driven challenge to the authors' theoretical claims, see James R. Hines, Jr. et al., *The Attack on Nonprofit Status: A Charitable Assessment*, 108 MICH. L. REV. 1179 (2010). The authors argue that additional tax benefits will create incentives for for-profits to enter or increase their presence in industries populated by nonprofits. For-profits will crowd out nonprofits as they enter mixed industries and cause the behavior of nonprofits to shift away from their other-regarding missions. *See id.* at 1199–1203. The authors also point out that it may be unnecessary to extend tax benefits for the community benefit activities undertaken by for-profits, as losses in profitability as a result of these activities will be accompanied by equivalent decreases in tax liability, and that Malani and Posner's proposal will create opportunities for tax arbitrage that will be difficult to police. *See id.* at 1213–15.

162 *See What Is Google.org?*, GOOGLE.ORG, <http://www.google.org/about.html> (last visited Jan. 28, 2011).

163 *See id.*; *see also* Sheryl Sandberg, *About Google.org*, GOOGLE.ORG BLOG (Oct. 11, 2005, 9:02 PM), <http://googleblog.blogspot.com/2005/10/about-googleorg.html> (stating that Google does not “expect to make further donations to the Foundation for the foreseeable future”). At the time it was launched, Google.org leader Larry Brilliant explained “Google.org can play the entire keyboard, it can start companies, build industries, pay consultants, lobby, give money to individuals and make a profit.” *See* Stephanie Strom & Miguel Helft, *Google Finds It Hard to Reinvent Philanthropy*, N.Y. TIMES, Jan. 30, 2011, at BU1 (quoting from an earlier New York Times interview).

164 *See What Is Google.org?*, *supra* note 162.

165 *See* Dana Brakman Reiser, *For-Profit Philanthropy*, 77 FORDHAM L. REV. 2437, 2466–67 (2008); Fishman, *supra* note 24, at 607.

only be reinvested in future philanthropy.¹⁶⁶ Today, Google.org has shifted its focus yet again. Now it concentrates on engineering projects that use Google Inc. resources to achieve social goals.¹⁶⁷ While Google.org continues to evolve, its development demonstrates the frustration of charity innovators with the limitations of charity law, and how they are seeking to escape them.

Although the founders of social enterprises generally do not seek charity status, reasoning like Palotta's or Malani and Posner's could also bring these organizations within the charity fold. These companies gauge their success by two metrics—earning profits for owners and achieving some measure of social or community benefit, perhaps doing the former to enable the latter.¹⁶⁸ Current charity law rejects a double-bottom line approach to charity due to the taint of profit distribution. These enterprises are unable to form as nonprofit corporations or charitable trusts; they cannot obtain federal or state tax exemption. By distributing profits to shareholders or other owners, social enterprises clearly breach the nondistribution constraint and pursue self-regarding objectives. Yet, the founders of these entities tout their combination of other-regarding and self-regarding objectives as their hallmark.¹⁶⁹ When an entity and its owners can “do well by doing good,” they see a strong hand forcing entities classed as charitable to pursue charity alone as short-sighted.¹⁷⁰

Legislative innovations also figure here. Since 2008, seven U.S. states have enacted legislation authorizing the low-profit limited liabil-

166 See Katie Hafner, *Philanthropy Google's Way: Not the Usual*, N.Y. TIMES, Sept. 14, 2006, at A1; Harriet Rubin, *Google's Searches Now Include Ways to Make a Better World*, N.Y. TIMES, Jan. 18, 2008, at C1.

167 See Strom & Helft, *supra* note 163 (describing this change of focus and commenting that now Google.org's “hyperbole looks more like hubris”); *What Is Google.org?*, *supra* note 162; see also Larry Brilliant, *The Next Chapter for Google.org*, GOOGLE.ORG BLOG (Feb. 23, 2009, 4:17 PM), <http://blog.google.org/2009/02/next-chapter-for-googleorg.html> (describing shift in focus).

168 See J. Gregory Dees & Beth Battle Anderson, *For-Profit Social Ventures*, in SOCIAL ENTREPRENEURSHIP 1, 2 (Marilyn L. Kourilsky & William B. Salstad eds., 2003) (referring to these entities as “for-profit social ventures”).

169 See Thomas Kelley, *Law and Choice of Entity on the Social Frontier*, 84 TUL. L. REV. 337, 339 (2009); see also, e.g., Marci Alboher, *A Social Solution, Without Going the Non-profit Route*, N.Y. TIMES, Mar. 5, 2009, at B5 (quoting one social enterprise founder's position that “[w]e could have done it as a nonprofit over a hundred years, but if we wanted to do it in five or 10 years, then we believed it needed to be fueled by profit”); Steve Lohr, *A Capitalist Jolt for Charity*, N.Y. TIMES, Feb. 24, 2008, at B1 (quoting another founder saying his company “needs to be a large business to have a really significant social impact We couldn't do what we're doing as a nonprofit.”).

170 See JOHN ELKINGTON & PAMELA HARTIGAN, THE POWER OF UNREASONABLE PEOPLE 117–20 (2008).

ity company (L3C) form hybridizing for-profit and nonprofit elements.¹⁷¹ The L3C tweaks the LLC form of organization. An L3C is formed to pursue traditionally charitable activities, but also contemplates making some, albeit likely low, profit.¹⁷² The L3C enabling legislation prohibits income production from being a “significant purpose of the company . . . provided, however that the fact that a person produces significant income or capital appreciation shall not, in the absence of other factors, be conclusive evidence [that income production is] a significant purpose.”¹⁷³

Individuals or entities may be members of an L3C with rights in governance and to distributions.¹⁷⁴ Any rights to distributions and the distributions themselves, however, need not be identical across members.¹⁷⁵ This flexibility would enable some L3C members to contribute capital to the entity as investors, entitling them to a share in the entities’ midstream or residual profits.¹⁷⁶ Such investors might seek a market-rate return or a lower one, combined with the opportunity to make social or psychic gains from a socially responsible investment. Other L3C members could contribute capital in a transaction financially akin to a donation, making contributions with no intent to receive a financial return.¹⁷⁷ Indeed, the explicit goal of this legislation is to provide an organizational form that will signal to foundations that an entity is an appropriate recipient of program-related

171 See Dana Brakman Reiser, *Governing and Financing Blended Enterprise*, 85 CHI.-KENT L. REV. 619, 620 (2010); Ann Meyer, *Firms with Social Bent See Payoff in New Law*, CHI. TRIB., Aug. 10, 2009, at 19 (noting Illinois’s enactment of L3C legislation); Nicole Wallace, *Tough Economy Offers New Opportunities for Charity-Run Businesses*, CHRON. PHILANTHROPY, May 7, 2009, at 33 (describing Michigan, Wyoming, Utah, and the Crow nation’s adoption of legislation recognizing the L3C); *Laws*, AM. FOR COMMUNITY DEV., <http://www.americansforcommunitydevelopment.org/laws.php> (last visited Mar. 14, 2011) (listing Louisiana, Maine, North Carolina, Vermont, and the Oglala Sioux nation as additional jurisdictions that have adopted L3C legislation); *Legislative Watch*, AM. FOR COMMUNITY DEV., <http://www.americansforcommunitydevelopment.org/legislativewatch.php> (last visited Jan. 28, 2011) (listing twenty additional states considering L3C legislation). See generally Kelley, *supra* note 169, at 353–76 (reviewing efforts to create hybrid legal entities and noting the particular promise of the L3C).

172 See, e.g., VT. STAT. ANN. tit. 11, § 3001(27)(A)(i) (1997).

173 See *id.* § 3001(27)(B).

174 See Hines, Jr. et al., *supra* note 161, at 1189.

175 See Robert Lang, *Americans for Community Development L3C Overview*, AM. FOR COMMUNITY DEV., 3–4, <http://americansforcommunitydevelopment.org/supportingdownloads/ACDOverview.pdf> (last visited Sept. 1, 2010).

176 See *id.* at 3.

177 See *id.* at 4.

investments¹⁷⁸ for which contemplation of a return as a motive is specifically barred.¹⁷⁹ The pass-through nature of federal taxation of LLCs means that an L3C entity itself will not be taxed; individual members' earnings will be taxed according to their independent tax status.¹⁸⁰ By permitting both donor-type and investor-type members, the L3C form explicitly melds other-regarding and self-regarding modes of operation.¹⁸¹

Across the Atlantic, another hybrid form of organization poses challenges to the other-regarding orientation requirement. The community interest company (CIC) is an entity formed under U.K. company law, and may be either limited by shares (similar to our for-profit conception) or limited by guarantee (similar to our nonprofit conception).¹⁸² However, CICs have several important characteristics that differentiate them from typical U.K. companies. A CIC must pass a community interest test, showing "that its purposes could be regarded by a reasonable person as being in the community or wider public interest"¹⁸³ and it must report on its community interest achievements annually.¹⁸⁴ A CIC must also "confirm that access to the benefits it provides will not be confined to an unduly restricted group."¹⁸⁵ When a CIC is limited by shares, it may have share owners entitled to dividends, though these dividends are subject to a cap. Moreover, share owners will not share in the residual profits on winding up of the company. A CIC's assets are subject to an "asset lock" whereby on dissolution all assets must go to a charity or another CIC.¹⁸⁶ All of this is overseen by a dedicated CIC regulator.

178 See *id.* at 2; see also John Tyler, Negating the Legal Problem of Having "Two Masters": A Framework for L3C Fiduciary Duties and Accountability 4–7 (unpublished manuscript) (on file with author).

179 See I.R.C. § 4944(c) (2006) (mandating that "no significant purpose" of a program-related investment "is the production of income or the appreciation of property"). Qualified program-related investments count toward a private foundation's five percent annual payout requirement.

180 See Lang, *supra* note 175, at 2.

181 One proposed use of the L3C vehicle would employ tranches of members, each with a different combination of financial and governance rights. See *id.*

182 See REGULATOR OF CMTY. INTEREST COS., FREQUENTLY ASKED QUESTIONS 4 (Oct. 2009) [hereinafter CIC FREQUENTLY ASKED QUESTIONS], available at <http://www.cicregulator.gov.uk/CICleaflets/FAQ%20%20October%202009%20V5.00%20Final.pdf>.

183 See *id.* at 8.

184 See *id.* at 11.

185 See *id.* at 8.

186 See *id.* at 9.

In the CIC, again, other-regarding and self-regarding modes are intentionally blended. On the one hand, the CIC must provide its benefits to some relatively large class and some core of a CIC's assets must be irrevocably dedicated to community interest or charitable purposes.¹⁸⁷ On the other hand, the CIC entails a kind of equity investment where the shareholders are permitted to engage in profit-taking. Investors may purchase shares in a CIC, shares that entitle them to capped dividends that will vary depending upon the entity's profits, though not to residual earnings on dissolution. Thus, the CIC offers observers an alternative model for hybridization and weakening of the other-regarding orientation requirement,¹⁸⁸ though one that the U.K. has deemed to fall outside the charity category.¹⁸⁹

The B Corporation initiative also attempts to create a hybrid brand for enterprises blending self- and other-regarding modes of operation, but until recently without a legislative imprimatur. A "B" or "for-benefit" corporation incorporates under traditional state for-profit corporation law, but commits itself to "use[] the power of business to solve social and environmental problems."¹⁹⁰ B corporations solemnize this commitment by adopting language in their governing documents instructing their directors to consider the interests of employees, suppliers, customers, the community, and society at large in carrying out their duties.¹⁹¹ Further, before an entity may use the "B" designation, it must be vetted by B Lab, a third-party certification entity that controls the trademark.¹⁹² This combination of self-regulation and a private contracting and certification system has not yet been fully tested, but it provides a framework for institutionalizing and standardizing a form blending self-regarding and other-regarding

187 See *id.* at 4–5. These requirements are intentionally broader than U.K. law's definition of charity. In fact, CICs expressly fall outside the United Kingdom's charitable category, and existing charities converting to CIC form will lose charity status. See *id.*

188 See Oonagh Breen, *Holding the Line: Regulatory Challenges in Ireland and England when Business and Charity Collide* 22 (Nov. 2009) (unpublished conference draft) (on file with author) (describing the CIC as "a halfway house between a fully commercial enterprise and a charity").

189 See *Companies (Audit, Investigation and Community Enterprise) Act, 2004*, § 26(3)(a) (U.K.).

190 *Introducing the B Corporation*, CERTIFIED B CORP., 3 (2009), http://www.bcorporation.net/resources/bcorp/documents/2009%20B%20Corp_Intro_Package.pdf.

191 See *Legal Framework*, CERTIFIED B CORP., <http://www.bcorporation.net/become/legal> (last visited Jan. 28, 2011).

192 See *About Certified B Corps*, CERTIFIED B CORP., <http://www.bcorporation.net/about> (last visited Jan. 28, 2011).

behavior. In addition, Maryland adopted enabling legislation for a statutory "benefit corporation" modeled on B Lab's concept in April 2010, and several other states have followed suit.¹⁹³ This state-sanctioned corporate form will be available to entities vetted by private certification systems, which include B Lab's and potentially those of other entrants to the market.

Some commentators see these and other developments as sufficiently scalable that they predict a potential market for charity.¹⁹⁴ The over \$150 billion market for socially responsible investments suggests that at least some segment of consumers are interested in investing funds in entities that blend the desire for profits with the desire for social good.¹⁹⁵ Experiments with charitable or social "initial public offerings" (IPOs) further demonstrate the growing cache attached to challenging the other-regarding orientation requirement.¹⁹⁶ These efforts purport to sell ownership and use the trappings of an IPO, but in fact offer investment units that are economically indistinguishable from donations, with no profit-sharing element.¹⁹⁷ Of course, these IPOs are in reality little more than marketing ploys, but initiating charities believe the message of ownership will be salient enough to publicize it. This belief is quite astounding if one believes in the unsailability of other-regarding orientation.

Developments blending charity and business challenge the wisdom of charity law's other-regarding orientation requirement, its strongest and most fundamental policy prescription. Commentators question its utility. Innovators sidestep it by forming entities as for-profits, and pursuing hybrid forms through legislation or otherwise. Even some traditional charities have taken on programs that may suggest comfort with relaxing the other-regarding essential. Although these challenges to the other-regarding orientation requirement offer

193 See 2010 Md. Laws 97; see also Diane Mastrull, *Maryland Adopts New Socially Aware Corporation Law*, PHILA. INQ., Apr. 15, 2010, at C01 (describing the new law and noting its October 2010 effective date). For a review of the statutory benefit corporation organizational form, see Dana Brakman Reiser, *Benefit Corporations—A Sustainable Form of Organization?*, 46 WAKE FOREST L. REV. (forthcoming 2011).

194 See, e.g., PALOTTA, *supra* note 143, at 121; Kelley, *supra* note 169, at 360–62; Lang, *supra* note 175, at 4–7.

195 See DAVID VOGEL, *THE MARKET FOR VIRTUE* 60 (2005) (reporting that in 2003, \$151 billion was under management with investment funds that screen companies for social impact); Jim Brown, *Equity Finance for Social Enterprises*, 2 SOC. ENTERPRISE J. 73, 74–75 (2006) (providing anecdotal information on the demand for "ethical investment").

196 See *The Business of Giving: Non-Profit Capitalism*, ECONOMIST, Sept. 13, 2008, at 72.

197 See *id.*

valuable insights on charities and charity law, they should ultimately be rebuffed.

The other-regarding orientation requirement is core to enforcing the mission imperative of charity law. For fiduciaries and members, the law expressing this essential serves as a useful prophylactic. Determining mission and the appropriate way to pursue it is a challenge for every charity and its constituents. But, the other-regarding orientation requirement warns a director, officer, or member away from attempting to serve two masters—one of whom is herself. This adds at least some boundaries to notoriously muddy decisionmaking. While charities are and should be given great autonomy in selecting the means by which their sundry charitable missions are met, the mission imperative is what gives the charitable category its utility for society and for its stakeholders. The other-regarding essential plays a vital reinforcing role in mission accountability, to which already stretched external enforcement mechanisms will rarely and should rarely address their efforts.

The other-regarding essential also helpfully delineates the charity category for other major charity stakeholders. Charity law defines those entities solely devoted to achieving a charitable mission, staking them out as safe places for donors and the public to send their contributions and tax dollars without concern that they will someday be diverted to private ends. Of course, donors will never obtain complete assurance that their particular charitable goals will continue to be met by charities, which can go in and out of existence and change their purposes over time (sometimes with and sometimes without regulatory supervision).¹⁹⁸ Yet, charity stakeholders rely on the legal prohibitions of self-regarding behavior to provide some minimal assurance of a charity's enduring mission to benefit society, which the available enforcement architecture will have some reasonable ability to police. The Palotta and Malani/Posner proposals should therefore be resisted. Equity share ownership of charities should not be permitted, nor should for-profit entities be admitted to the status of charity. The other-regarding essential should be maintained and conspicuously enforced.

Yet, there are important lessons to be learned from recent charitable innovations, particularly their forceful demonstration that charitable activities and purposes are not and should not be the sole purview of charities. Again, the key distinction is between being a charity and being an entity that engages in charitable activities or has, among others, charitable purposes. For-profit or mixed entities make

198 See Brakman Reiser, *supra* note 45, at 226–30.

valuable contributions to society, for which they should be lauded. Moreover, clinging to the other-regarding orientation requirement will necessarily limit the types and quantity of charity funding available. Broadening the range of entities empowered and encouraged to engage in charitable activities may provide access to additional revenue streams to fund these activities. New and distinct tax or other benefits may even be warranted to further encourage noncharities to undertake charitable activities and to blend their self-regarding purposes with their other-regarding ones.

B. *Singular Charity*

As noted, the group governance requirement is only weakly expressed in current charity law.¹⁹⁹ Incorporated charities generally must be run by boards and those organized as unincorporated associations must have members. Yet, a voting membership is optional for incorporated charities and many practitioners recommend structuring charities without voting members precisely to avoid the complications and complexity created by group operation.²⁰⁰ More shockingly, charities taking the trust form may be governed by a single trustee,²⁰¹ and this course too has its advocates in practice. Charity law should be reformed to take better account of the critical role group governance plays in enforcing mission accountability. A single individual's vision of the good is insufficient to merit treatment and favor as a charity. While not every group needs to have members and be democratically governed, a strong group governance model is vital to encourage the dialogic process of evaluating and evolving mission. The idea that charitable mission will be something identified by a group and legitimately evolved by it is fundamental to enforcing the mission imperative.

Charity law should prohibit single director incorporated charities and single trustee charitable trusts.²⁰² The most expedient route to this reform would simply add a group governance requirement to federal tax exemption law. Those concerned about federalization of charity law, however, would likely prefer to bar these structures under

199 See *supra* Part I.B; see also Silber, *supra* note 47, 72–86 (describing a trend away from consultation in governance both in nonprofit law and practice).

200 See FREMONT-SMITH, *supra* note 19, at 159.

201 See Brody, *supra* note 48, at 645.

202 To be clear, I suggest mandatory reform of entities currently structured with a single director or trustee, not dismantling them and certainly not forfeiting their assets away from the charitable stream.

each state's relevant organizational laws.²⁰³ If this reform could be universally accomplished, federal and state tax law's reliance on state organizational form as a predicate for exemption would bring all relevant sources into alignment with a strong group governance norm.²⁰⁴ Jurisdictional variation on the number of fiduciaries a charity requires, on the other hand, would likely lead to forum shopping.

At whatever level of government this reform is pursued, it will be more politically difficult to prohibit single trustee charitable trusts than single director charitable corporations. Single trustee trusts are used to speed formation, entrench donor control, and limit evolution of charitable purpose. Speeding formation is an understandable and reasonable goal; worthy charitable missions can arise in an instant and there must be a way to address them swiftly. However, the corporate form can be very speedily acquired in many states.²⁰⁵ States with slow corporate registration facilities should speed them up for independent reasons. Even when a trust is the only option for speedy creation, finding two additional trustees to meet a three-trustee requirement should not impose too great a burden.

The other reasons to use a single-trustee trust, entrenching donor control, and limiting evolution of charitable purpose, are not likewise appropriate aims for charities. When a donor makes a donation to a charity with perpetual life, the donor does and should lose control to the entity charged by society to pursue the charitable mission defined by its documents and as legitimately evolved over time.²⁰⁶ The group governance essential stands in opposition to the idea that this mission may be bound to the views of a single person. The group it envisions is important precisely because of the need for charities to evolve their missions, and thus enforces the mission imperative.

Of course, mandating that charities be governed by more than a single individual will not suffice to guarantee strong group governance.²⁰⁷ Directors may lack sophistication about matters brought to their attention. Even highly motivated and sophisticated directors will

203 See Brody, *supra* note 48, at 683–84; see also Fishman, *supra* note 70, at 578–91 (noting federalism problems with pursuing governance aims through federal tax exemption law).

204 The same jurisdictional choice dynamic applies to the other group governance reforms I advocate here, though I will not repeat it with respect to each proposal.

205 See FREMONT-SMITH, *supra* note 19, at 152.

206 See John F. Coverdale, *Legislating in the Dark: How Congress Regulates Tax-Exempt Organizations in Ignorance*, 44 U. RICH. L. REV. 809, 812 (2010).

207 Of course, group decisionmaking can be slow and indecisive. These unavoidable costs are outweighed by the benefits of group governance for enforcing mission accountability.

suffer from serious information deficits relative to charities' managers and employees.²⁰⁸ This information asymmetry, relevant personalities, or both may also lead to domination by a charity's executive director or CEO. Finally, simple group dynamics may lead to groupthink and its accompanying risks of stagnation and suboptimal decisions.²⁰⁹ Each of these potential problems threatens the ability of a governing body to operate as a truly dialogic structure. Fortunately, multiple legal innovations can be used to strengthen boards' ability to embody more than merely formal group governance.

First, charity law's commitment to group governance should be shored up by strengthening its commitment to fiduciary independence and board diversity. A board with a majority of related or financially interested members may nominally utilize group governance, but the group members can be too easily dominated and therefore unable to serve the purpose of promoting dialogue on issues of mission. To avoid these situations where group governance is seriously undermined, independence requirements should demand that boards be composed of a majority of unrelated and financially unconflicted directors.²¹⁰ To make greater strides toward achieving board diversity stimulating real dialogue, independence requirements could alternatively limit the percentage of directors with specific kinds of relationships with or interests in the charity. Such a requirement might require and limit board service by donors and beneficiaries, in addition to those with financial or familial relationships with the charity. This more sweeping type of requirement would have to target a percentage of directors large enough to be relevant in board discussions and building coalitions, but small enough to avoid screening out too many categories of qualified and interested board candidates.²¹¹ Of course, best practice guides, self-regulatory programs, training efforts, and practitioner advice should also encourage charities to consider independence and diversity when screening fiduciary candidates, as a complement to statutory mandates.

Fiduciary law itself should also more clearly articulate charity fiduciaries' responsibility to act within an operational group. The law regulating incorporated charities nods to this concept with structural

208 See Elizabeth Cosenza, *The Holy Grail of Corporate Governance Reform: Independence or Democracy?*, 2007 BYU L. REV. 1, 23–25.

209 See Melanie B. Leslie, *The Wisdom of Crowds? Groupthink and Nonprofit Governance*, 52 FLA. L. REV. (forthcoming Dec. 2010), available at <http://ssrn.com/abstract=1477553>.

210 See Brakman Reiser, *supra* note 62, at 829–30.

211 See *id.* at 829–31.

requirements like quorum and voting rules.²¹² Commentators concerned about charity boards' frailties have proposed reforming fiduciary law to better reveal or limit charity fiduciaries' private interests as they pursue their directorial roles,²¹³ or to focus them more actively on pursuit of charity mission.²¹⁴ The proposed ALI Principles of the Law of Nonprofit Organizations "endorse[s], for all charities, the trust law's imposition of an obligation of cooperation on cofiduciaries."²¹⁵ These reforms could nicely coexist with a structural commitment that part of a charity fiduciary's obligation is to function within and maintain the vitality of a governing group.

Finally, charity law could mandate voting membership structures in incorporated charities. Although voting membership structures employing a sole corporate member likely will not meet a strong ideal of group governance, a legal mandate that incorporated charities empower a pool of individual voting members would forcefully embrace the group governance norm. While I support measures encouraging the use of voting members, I do not recommend mandating their use. Charities often opt not to use voting members because of the practical difficulty of attracting individual members, tracking them over time, and obtaining sufficient participation by them to achieve a quorum for necessary corporate decisions.²¹⁶ Amending nonprofit corporate statutes to require all incorporated charities to empower members to elect directors would likely stimulate a wave of charity transformations into trust form, or simply result in directors being named members as well.²¹⁷ Neither of these effects would cause charities to be more accountable to their missions. Charity law should encourage the use of voting members, but this is a place where charity law may be able to do only so much. Many other forces are at work in shaping charities' operation, keeping them relevant and vital. Practitioners, as well as those authoring best practice guides

212 See FREMONT-SMITH, *supra* note 19, at 220.

213 See Melanie B. Leslie, *Conflicts of Interest and Nonprofit Governance: The Challenge of Groupthink*, 85 CHL-KENT L. REV. 551, 569 (2010) (recommending a flat prohibition on charity fiduciary self-dealing or, alternatively, requiring disclosure of conflicts, investigation of alternatives, and proof that self-dealing transactions offer below-market pricing in order to counter the perils of groupthink).

214 See Linda Sugin, *Resisting the Corporatization of Nonprofit Governance: Transforming Obedience into Fidelity*, 76 FORDHAM L. REV. 893, 921-22 (2007) (arguing charity fiduciaries owe a duty of fidelity to charitable mission).

215 PRINCIPLES OF THE LAW OF NONPROFIT ORGANIZATIONS § 320 cmt. a(2) (Tentative Draft No. 1, 2007).

216 See Dana Brakman Reiser, *Dismembering Civil Society: The Social Cost of Internally Undemocratic Profits*, 82 OR. L. REV. 829, 887-90 (2003).

217 See *id.*

and training materials should promote the use of democratic governance structures,²¹⁸ as well as the development of other means to promote dialogue about organizational mission.²¹⁹

Reinforcing charity law's commitment to group governance will guide its response to developments like for-profit philanthropy and social enterprise. If unincorporated for-profit forms could be used to create charities, the group essential would be seriously undermined. The most obvious challenge is the sole proprietorship, which is a form currently available to businesses but not to charities, and which is pervasive throughout the for-profit sector.²²⁰ The sole proprietorship would offer a charitable innovator the greatest control, in fact the ability to create a singular charity. The partnership form sets group governance as its default model, whereby all partners have equal rights to participate in management.²²¹ However, the group may be as small as two, and the defaults may be changed significantly.²²² The enabling nature of partnership statutes also allows founders to retain considerable control through agreements and variations in governance structure.²²³ They may retain management rights and limit the governance rights of new partners to a substantial degree. In an LLC, the level of commitment to group governance may depend on whether a member- or manager-managed structure is employed.²²⁴ Still, if any of these unincorporated for-profit forms become permissible methods of organizing a charity, their inherent flexibility would undercut the group governance norm.

Serious, though somewhat different, challenges to the group essential would arise from permitting incorporated for-profit forms

218 See Angela M. Eikenberry, *Refusing the Market: A Democratic Discourse for Voluntary and Nonprofit Organizations*, 38 *NONPROFIT & VOLUNTARY SECTOR Q.* 582, 591–92 (2009).

219 See Dana Brakman Reiser, *Filling the Gaps in Nonprofit Accountability: Applying the Club Perspective in the U.S. Legal System*, in *VOLUNTARY REGULATION OF NGOs AND NON-PROFITS* 41, 51–61 (Aseem Prakash & Mary Kay Gugerty eds., 2010) (suggesting a role for self-regulation in stimulating dialogue on charitable mission).

220 See U.S. CENSUS BUREAU, *STATISTICAL ABSTRACT OF THE U.S.* tbl.722 (2010) (showing business tax returns from sole proprietorships outnumber corporations and partnerships by four to ten times).

221 See, e.g., UNIF. P'SHIP ACT § 18(e) (amended 1997) ("All partners have equal rights in the management and conduct of the partnership business.").

222 *Id.* § 6.

223 See, e.g., *id.* § 37 (using language such as "unless otherwise agreed").

224 See UNIF. LTD. LIAB. CO. ACT § 404 (1996) (describing members' rights in management in each alternative form). See generally Delaware Limited Liability Company Act, DEL. CODE ANN. tit. 6, § 18 (2005 & West Supp. 2008) (similar); REVISED UNIF. LTD. LIAB. CO. ACT § 407 (2006) (similar).

for charities. The details here in part depend on whether the for-profit corporation is private and closely held or is a publicly held entity. The corporate architecture of a corporation introduces risks that nonfounder shareholders may dilute a founder's commitment to her charitable mission, in favor of instead pursuing profit for themselves. The number and proximity of closely held shareholders, however, may blunt these risks from group governance. Additionally, founders of close corporations may be able to protect their charitable mission by aggressively screening potential investors, maintaining a control position, crafting defensive shareholder agreements, or a combination of these strategies. These are not foolproof tactics, of course, as even carefully screened new shareholders might deceive founders or change their minds over time. Shareholder agreements can create significant limitations on shareholder actions, but can be held invalid if they restrict transferability unreasonably²²⁵ or "clear[ly] conflict with the governing corporate statute."²²⁶

If an incorporated for-profit charity becomes a publicly held corporation, further challenges to the group essential will arise. Bringing on a broad group of public shareholders creates significant dangers for a charity and its founders. Common shareholders endowed with voting powers can obtain board representation, exert veto power on major transactions, and enable or even engage in takeover action. All of these means could be used to shift an entity's mission away from charitable purposes and toward more typical for-profit objectives. They would do so precisely by using the group governance model mandated by for-profit corporate law. Again, to protect their position, founders will likely try to maintain a strong majority or controlling position.

Founders of a corporation about to seek broad equity investment may also adopt governance structures to protect its charitable mission. Again, these structures will enhance founder control at the expense of empowering a larger and more diverse group in governance. For example, Google Inc.'s equity structure uses two classes of stock, one held by founders and one held by ordinary common shareholders.²²⁷ The founders' stock class holds a significant voting advantage. This structure was established prior to the inception of Google.org, motivated by its founders' desire to maintain their authority despite a

225 See JAMES D. COX ET AL., CORPORATIONS § 14.9, at 374–75 (1997).

226 See *id.* § 14.5, at 369.

227 See DAVID A. VISE & MARK MALSEED, THE GOOGLE STORY 172 (2005).

move to public share ownership and to stave off takeover threats.²²⁸ It was made known to shareholders in the stock's initial public offering and has remained a matter of public notice.²²⁹ This two-tier structure now offers substantial security for the founders' mission, including their commitment to for-profit philanthropy.²³⁰ Yet, it also undermines group governance. With incorporated for-profit corporate models, the law's commitment to group governance becomes a risk to its founders' charitable motives and founders respond by maintaining tight control.²³¹

The advent of social enterprise and for-profit philanthropy makes it ever more important to appreciate and fill the gaps in charity law's commitment to group governance. While these entities and concepts should likely be encouraged, they should not be designated as charities. There is too much pressure on these entities to entrench control with founders. Mission accountability requires retaining and enforcing the idea that a charity is a group, not an individual endeavor. This is fundamentally incompatible with existing for-profit organizational forms.

The hybrid forms of organization described above express various levels of commitment to group governance. The charter amendments required to obtain "B" certification or statutory benefit corporation status require directors to consider the interests of employers, suppliers, the community, and society in making decisions on behalf of the corporation.²³² As "B" corporations must incorporate in states with constituency statutes permitting directors to consider nonshareholder interests in exercising their duties, such language seems to provide a safe harbor from fiduciary liability in situations where shareholder interests are sacrificed for some broader social purpose.²³³ Still, if a sufficient number of shareholders change their minds about the "for-

228 See Google Inc., Amendment No. 9 to Registration Statement (Form S-1), at 29-30 (Aug. 18, 2004), available at <http://www.sec.gov/Archives/edgar/data/1288776/000119312504142742/ds1a.htm>.

229 See *id.*

230 See Brakman Reiser, *supra* note 165, at 2437, 2467-68.

231 See, e.g., Dees & Anderson, *supra* note 168, at 17-19; see, e.g., MD. CODE ANN. CORPS. & ASS'NS § 5-6C-07(A)(1) (LexisNexis 2011) (providing a long list of interests directors of benefit corporations "shall consider" in directorial decisionmaking).

232 See *Legal Framework*, *supra* note 191 (requiring directors to consider the interest of a wide range of stakeholders, the community, and broader society in determining actions that will be in the company's best interests).

233 See 1 AM. LAW INST., PRINCIPLES OF CORPORATE GOVERNANCE § 2.01 cmt. 6 (1994) ("[T]here is little doubt that [restrictions on the general profit-making objective] would normally be permissible if agreed to by all the shareholders. Such an agreement might be embodied in the certificate of incorporation, or not.").

benefit” approach, or are willing to sell their shares to buyers holding a different view, these amendments can be undone.²³⁴ Moreover, the “B” and statutory benefit corporation amendments change only the standards for director governance; they do not empower shareholders to do more nor do they bestow governance rights upon a broader stakeholder group.²³⁵

The L3C, structured as it is on an LLC model, envisions a role for members in some type of group governance, at least as a default. If an L3C uses a member-managed structure, its members will have the right to participate in governance.²³⁶ A manager-managed model delegates power for most management decisions to the manager, but retains members’ governance rights over certain major company decisions as well as empowering them to recall the manager.²³⁷ Part of what makes the L3C attractive, however, is the extreme flexibility of its LLC base when it comes to governance.²³⁸ L3C founders concerned about maintaining the organization’s hybrid orientation can use this flexibility to adopt governance structures providing them with power and additional safeguards. A manager-managed model, with its limited role for the larger governing constituency, is the most straightforward of these. A structure could also be crafted to privilege one class of members with a role in governance, while disempowering other member classes, again in the hopes of protecting the entities’ double-bottom line or social enterprise orientation. Available model

234 See *Make It Official*, CERTIFIED B CORP., <http://www.bcorporation.net/become/official> (last visited Jan. 28, 2011) (explaining continuing commitments to remain a “B” corporation).

235 See *Legal Roadmap*, CERTIFIED B CORP., <http://survey.bcorporation.net/become/legal2.php> (stating in its recommended bylaw changes that they are not “intended to create or shall create or grant any right in or for any person or any cause of action by or for any person”) (last visited Jan. 28, 2011); see e.g., MD. CODE ANN. CORPS. & ASS’NS § 5-6C-07(B) (“A director of a benefit corporation, in the performance of duties in that capacity, does not have any duty to a person that is a beneficiary of the public benefit purposes of the benefit corporation.”).

236 See, e.g., Delaware Limited Liability Company Act, DEL. CODE ANN. tit. 6, § 18 (2005 & Supp. 2008) (providing each member equal rights in managing the LLC and providing that most matters “be decided by a majority of the members”); REVISED UNIF. LTD. LIAB. CO. ACT § 407 (2006) (same); UNIF. LTD. LIAB. CO. ACT § 404(a) (1996) (same).

237 See DEL. CODE ANN. tit. 6, § 18; REVISED UNIF. LTD. LIAB. CO. ACT § 407; UNIF. LTD. LIAB. CO. ACT § 404(b)–(c).

238 See Lang, *supra* note 175, at 3–4.

operating agreements demonstrate the allure of designing structures such to entrench the power and views of founders.²³⁹

The L3C also carries limits on transferability of memberships. Like in LLCs generally, while memberships may be transferred, governance rights do not automatically follow sale and are instead contingent on existing members accepting the transferee.²⁴⁰ The impact of this potential restriction on group governance and its mission-based goals is uncertain. Locking members into the entity may make them more interested in engaging in group governance, bolstering it. Yet, limiting transferability could also curtail the range of potential investors for the organization and the organization's ability to evolve its mission over time. It is difficult to measure the impact of the L3C on group governance yet, as it is so novel. The range of governance options is now limited only by the creativity of operating agreement drafters and their ability to obtain investors.

The U.K. CIC goes furthest to enshrine group governance in a hybrid form. CICs are required to have members, who will be share owners in a CIC limited by shares.²⁴¹ Yet, the CIC regulator also directs CICs to include a broad range of additional stakeholders in governance.²⁴² Recognizing that different techniques will succeed in different CIC types and sizes, the regulator does not demand a specific form of stakeholder involvement. Rather, it offers various suggestions of how the mandate to include stakeholders in governance might be achieved and requires CICs to report on their efforts to do so in their annual community interest report.²⁴³ Its guidance document explains:

The provision of adequate information is clearly the starting point for the consultation process together with the provision of easily used methods of feedback.

239 See *Legal, AM. FOR COMMUNITY DEV.*, <http://americansforcommunitydevelopment.org/legal.php> (last visited Jan. 28, 2011) (providing links to model operating agreements).

240 See Delaware Limited Liability Company Act, DEL. CODE ANN. tit. 6, § 18 (2005 & Supp. 2008); REVISED UNIF. LTD. LIAB. CO. ACT § 405; UNIF. LTD. LIAB. CO. ACT §§ 502, 503.

241 See REGULATOR OF CMTY. INTEREST COS., INFORMATION AND GUIDANCE NOTES ch. 9, at 4 (2009), available at [http://www.cicregulator.gov.uk/guidance/Chapter%209%20-%20October%202009%20\(version%205%20Final\).pdf](http://www.cicregulator.gov.uk/guidance/Chapter%209%20-%20October%202009%20(version%205%20Final).pdf).

242 See CIC FREQUENTLY ASKED QUESTIONS, *supra* note 182, at 12.

243 See *id.*; REGULATOR OF CMTY. INTEREST COS., *supra* note 241, ch. 8, at 3, available at <http://www.cicregulator.gov.uk/guidance/Chapter%208%20-%20October%202009%20%28version%203%20Final%29.pdf>.

This can be achieved by simple methods such as circulating news letters and holding stakeholder meetings or more sophisticated methods such as setting up a web site with dialogue facilities or issuing formal consultation documents before taking a major policy decision. Alternatively, stakeholder groups can be given official standing under a company's constitution (for example, by requiring that they are consulted before the directors or members make certain types of decisions).

Other stakeholders could be included with the members in the circulation of the company annual report and accounts and invited to attend an open forum linked to the company's annual general meeting.

In many organisations the setting up of user and advisory groups or a club committee separate from the board of directors can be an effective way of bringing stakeholders into the running of the organisation.²⁴⁴

Though they are given freedom to select a method for doing so, the form compels CICs to bring a greater variety of individuals into the governance process.

In terms of the group that will actively manage the corporation, the CIC offers a bit of a mixed bag. CICs organized as private companies may have only one director; other companies must have two or more, still not a large group.²⁴⁵ Like "B" corporation directors, CIC directors must make decisions not only to pursue share owner interests, but also with the goal of preserving the CIC's ability to meet the community interest test.²⁴⁶ Thus, founders can perhaps rely on directors to maintain the entity's social orientation, and share owners will not be able to discipline CIC directors away from it by making or threatening fiduciary challenges. Share owners in a CIC may also have less interest in directing their company away from a social enterprise orientation, as they have no right to residual earnings and even their ability to receive dividends is capped.

Innovations melding business and charity seriously challenge charity law's commitment to group governance. Permitting charities to adopt a for-profit framework would threaten complete abandonment of the group essential. In order to protect their control over a social enterprise vision, for-profit founders will select structures that approach singular governance. Hybrid forms of organization may

244 See REGULATOR OF CMTY. INTEREST COS., *supra* note 241, ch. 9, at 5.

245 See CIC FREQUENTLY ASKED QUESTIONS, *supra* note 182, at 13.

246 See REGULATOR OF CMTY. INTEREST COS., *supra* note 241, ch. 4, at 23, available at <http://www.cicregulator.gov.uk/guidance/CIC%20%20ch%204%20Oct%202009%20version%209%20final.pdf>.

offer opportunities to reassert the group governance norm, and the forms that have emerged are experimenting with this idea in different ways. Still, their commitment to group governance is tempered by a common flexibility as to governance structure. As hybrid forms are proposed and enacted, attention to group governance is crucial as charitably minded hybrid enthusiasts may remain understandably interested in entrenching founder control.

C. Commercial Charity

One need look no further than most the traditional charities to find challenges to charity law's anticommmerciality position. Charities already engage in substantial levels of commercial activity, and have done so for quite some time.²⁴⁷ The decision to do so is driven at times simply by the need to make up funding gaps in order to run their operations.²⁴⁸ Other times these activities are viewed as meshing with charitable mission and become an integral part of a charity's programs.²⁴⁹ Evidence of the blending of commercial and charitable activity can also be found in the for-profit arena. Over several decades, one finds a continuing trend toward proprietary firms offering traditionally charitable services.²⁵⁰ The social enterprise movement also exerts pressure on the anticommmerciality position.²⁵¹ If charity is fundamentally different from commercial enterprise, and commercial endeavors by charities (and charitable ones by businesses) should be looked at skeptically, why does this blending appear so pervasive and so attractive to charities and businesses?

Of course, current charity law does not render all kinds of commercial activity equally suspect. Its suspicion is principally reserved for commercial activities of questionable relation to charitable mission.²⁵² The commerciality and UBIT doctrines seize upon the con-

247 See Eleanor Brown & Al Silvinski, *Nonprofit Organizations and the Market*, in NONPROFIT SECTOR RESEARCH HANDBOOK, *supra* note 3, at 140, 146. See generally TO PROFIT OR NOT TO PROFIT, *supra* note 73 (examining the commerciality of nonprofit organizations by industry and over time).

248 See Brown & Silvinski, *supra* note 247, at 146–47.

249 See *id.*

250 See Joseph J. Cordes & C. Eugene Steurle, *The Changing Economy and the Scope of Nonprofit-Like Activities*, in NONPROFITS & BUSINESS, *supra* note 76, at 47, 51 [hereinafter Cordes & Steurle, *Changing Economy*]; Joseph J. Cordes & C. Eugene Steurle, *The Undivided Self: Are the Business Body and the Nonprofit Soul Separable?* 5 (unpublished manuscript) (on file with author) [hereinafter Cordes & Steurle, *Body and Soul*].

251 See *supra* notes 168–69 and accompanying text.

252 See *supra* notes 95–98 and accompanying text.

tent of commercial as compared with charitable activities, the relative size of a charity's commercial operations, and the manner of commercial business operation.²⁵³ The real impact of the commerciality limitations is thus to skew the choices a charity makes regarding commercial activity, to ensure the size, content, and manner of commercial activity will conform to charitable mission. While charities generally are propelled to engage in commercial activities by their need for additional funding streams,²⁵⁴ they do not simply engage in whatever commercial activity appears most likely to earn income.²⁵⁵ Instead, charities choose lines of business that will coalesce with their mission, make operational choices that will appear to align with it, or both.²⁵⁶ Further, they use related entities to structure their activities in ways that will avoid charity law's restrictions and penalties.²⁵⁷ Charities skew their commercial activities toward efforts they can defend as related to avoid commerciality challenges, the UBIT regime, or both.

Parallel to the significant commercial activity charities engage in today, one finds businesses more and more often pursuing traditionally charitable models.²⁵⁸ Indeed, the current economic crisis has produced proposals to combine for-profit businesses with charities to transform the former into the latter. Perhaps the most serious arguments in this vein are those suggesting that struggling news outlets might be sustainable if restructured as charities.²⁵⁹ Although no wide-

253 See *supra* notes 95–105 and accompanying text; see also Colombo, *supra* note 110, at 505 (“[T]he predominant doctrinal approach that appears to be used in practice by both the Service and many courts is first to determine whether an activity is conducted in a commercial manner and if so, to determine whether that activity is a substantial purpose of the exempt organization, in which case, exemption is denied.”).

254 See Weisbrod, *The Nonprofit Mission*, *supra* note 73, at 9; Weisbrod, *Pitfalls*, *supra* note 73, at 43.

255 See Weisbrod, *The Nonprofit Mission*, *supra* note 73, at 12–13.

256 See Joseph J. Cordes & Burton A. Weisbrod, *Differential Taxation of Nonprofits and the Commercialization of Nonprofit Revenues*, in *TO PROFIT OR NOT TO PROFIT*, *supra* note 73, at 83, 103–04; Dennis R. Young, *Alternative Perspectives on Social Enterprise*, in *NONPROFITS & BUSINESS*, *supra* note 76, at 21, 42–44.

257 See Colombo, *supra* note 110, at 514, 523–24.

258 See Cordes & Steurle, *Changing Economy*, *supra* note 250, at 54–64; Cordes & Steurle, *Body and Soul*, *supra* note 250, at 9–18 (suggesting this trend may be explained largely by the migration of the U.S. economy toward service provision and the use of information and highly specialized personal skills).

259 See Tim Arango, *Mother Jones Tests Nonprofit Model in Race to Survive the Recession*, *N.Y. TIMES*, Mar. 7, 2009, at C1 (reporting that *Mother Jones*, a longtime nonprofit magazine, received numerous inquiries as interest in nonprofit or endowed journalism began to grow); Charles Lewis & Bruce Sievers, *All the News That's Fit to Finance*, *CHRON. PHILANTHROPY*, Mar. 12, 2009, at 72 (detailing proposals advocating founda-

spread trend can yet be seen toward converting particular businesses or industries into charities, some real life examples have arisen. For example, when the for-profit *Seattle Post-Intelligencer* newspaper went out of business in early 2009, its owners launched a skeleton online successor to the paper.²⁶⁰ This successor employed very few former staff members and offered limited coverage.²⁶¹ Other staffers soon began a competing venture, Seattle PostGlobe.org, a charity formed as a nonprofit corporation.²⁶² This venture teamed with a local tax-exempt public television station as a fiscal sponsor and sought financing through a combination of advertising and donations.²⁶³

For-profits pursuing social enterprise also fundamentally challenge the idea that commercial and charitable activities must be kept separate. These entities manufacture products and offer services with dual goals of making profits for their owners and making the world a better place.²⁶⁴ Perhaps they use socially conscious sourcing in order to procure needed inputs from poor suppliers or in ways that foster local and indigenous production.²⁶⁵ They may employ individuals with limited employment prospects due to disability, socioeconomic situation, or particular life experiences.²⁶⁶ They may select their offerings based not only on consumer demand but on views of what products or services should be placed into the economy and the stream of commerce, with concerns about labor practices, environmental impact, or public health.²⁶⁷ These developments sharply question

tion and other donative funding for struggling newspapers). *See generally* JAMES T. HAMILTON, THE ROAD AHEAD FOR MEDIA HYBRIDS: REPORT OF THE DUKE NONPROFIT MEDIA CONFERENCE (2009), available at http://dewitt.sanford.duke.edu/images/uploads/About_3_Research_A_3_Report.pdf (analyzing the barriers to nonprofit foundations' ownership of media outlets); Marion R. Fremont-Smith, *Can Nonprofits Save Journalism? Legal Constraints and Opportunities* (Joan Shorenstein Ctr. on the Press, Politics and Pub. Policy Paper, 2009), available at http://www.hks.harvard.edu/press-pol/publications/papers/can_nonprofits_save_journalism_fremont-smith.pdf (discussing nonprofit journalism).

260 *See* Johnny Diaz, *Online Upstarts Deliver News Without the Paper*, BOS. GLOBE, May 14, 2009, at 5 (detailing the Seattle venture and several other similar ones); *Former P-I Staffers Launch Online Newspaper*, DEALBOOK (Apr. 15, 2009), <http://dealbook.blogs.nytimes.com/2009/04/15/former-p-i-staffers-launch-online-newspaper> [hereinafter *Former P-I Staffers Launch*].

261 *See* *Former P-I Staffers Launch*, *supra* note 260.

262 *See id.*

263 *See id.*

264 *See* Kelley, *supra* note 169, at 346.

265 *See* Dees & Anderson, *supra* note 168, at 3–5.

266 *See id.*

267 *See id.*

charity law's devotion to the idea that charity and commerce should be truly distinct.

Another important challenge can be seen in the move by individuals and firms to harness the profit-making potential of the poor as consumers. Perhaps the most dramatic example of this is found in the microfinance movement, most prominently associated with Mohammed Yunus and Grameen Bank.²⁶⁸ The Grameen model, begun in Bangladesh, is to offer very small loans to very poor borrowers. These loans come with relatively high rates of interest, but make financing available to borrowers who otherwise have no access to capital.²⁶⁹ The loans are used to fund micro-scale business enterprises, and borrowers are linked into a social network to foster norms regarding repayment.²⁷⁰ Grameen has shown profits using this model, and the model has been replicated in other under-banked communities.²⁷¹ Lending money in order to make a profit on interest payments is certainly a commercial activity and a Grameen-type entity would not qualify as a charity under U.S. charity law for this and other reasons. Yet, Grameen does not view itself as merely another profit-making enterprise but rather one marrying commercial activity and the desire to achieve social good.²⁷²

This has been suggested as a more generalized model by Bill Gates in his quest for "creative capitalism."²⁷³ He and others have suggested that if companies see the world's poor as an untapped source of consumers (and perhaps suppliers and employees), capitalism can

268 See *About Us*, GRAMEEN BANK, http://www.grameen-info.org/index.php?Itemid=164&task=blogsection&option=com_content&id=5 (last visited Jan. 28, 2011); see also MUHAMMAD YUNUS, *BANKER TO THE POOR* 115-50 (1998) (describing his creation of Grameen Bank and its growth over the years).

269 See Philip Nichols, *Legal Theory of Emerging Economies*, 39 VA. J. INT'L L. 229, 299-300 (1999).

270 See *Grameen Bank at a Glance*, GRAMEEN BANK, http://www.grameen-info.org/index.php?option=com_content&task=view&id=26&Itemid=175 (last visited Jan. 28, 2011).

271 See *id.*

272 See *Is Grameen Bank Different from Conventional Banks?*, GRAMEEN BANK, http://www.grameeninfo.org/index.php?option=com_content&task=view&id=27&Itemid=176 (last visited Jan. 28, 2011) (describing Grameen Bank as a "composite objective, coming out of social and economic visions").

273 See Bill Gates, Chairman, Microsoft Corp., Remarks at the World Economic Forum 2008: A New Approach to Capitalism in the 21st Century (Jan. 24, 2008) (transcript available at <http://www.microsoft.com/Presspass/exec/billg/speeches/2008/01-24WEFDavos.msp>); see also CREATIVE CAPITALISM (Michael Kinsley ed., 2008) (collecting essays on the creative capitalism idea); Janet E. Kerr, *The Creative Capitalism Spectrum: Evaluating Corporate Social Responsibility Through a Legal Lens*, 81 TEMP. L. REV. 831 (2008) (offering a model for evaluating CSR).

be used to bring them not only goods and services they need but also an improved quality of life.²⁷⁴ He argues that the motive to produce and expand both profits and recognition can propel companies to serve the needs of the world's poor.²⁷⁵ He calls on business leaders to take up this challenge in order to benefit the world—and their shareholders or owners.

The pressure on charity law's anticommerciality rules is real, building, and coming from all sides. Charity law should yield to this pressure by explicitly removing federal tax exemption limitations on charities' commercial activity and any state property tax law that bars property tax exemption for charities engaging in commercial activity. UBIT and state property tax rules that levy tax on charities' property used for commercial purposes should be maintained, in order to preserve the public fisc as needed. To the extent, however, that enforcing these regimes injects government into the internal decisions charities make about how best to achieve their missions, an attitude of general skepticism is warranted.

Of course, charities' tax-favored status makes this form attractive to individuals who wish not to engage in charity, but simply to avoid taxes. This raises two serious fears²⁷⁶ about my proposals, to which I propose two different solutions. The first concern is that some entities that are deemed by the law to be charities instead will be "for-profits in disguise," used as vehicles to transfer tax-free payments to insiders and others. Indeed, if a supposed charity abandons charitable programming and expenditures, and merely runs a commercial

274 See Gates, *supra* note 273; see also MATTHEW BISHOP & MICHAEL GREEN, PHILANTHROCAPITALISM (2008) (arguing that capitalism can be harnessed to pursue social good).

275 See Gates, *supra* note 273.

276 Another frequently raised concern is that charities engaging in commercial activities will create inappropriate and unfair competition with small and other businesses. Yet, as a revenue generation opportunity, it is difficult to see why charities aiming to produce as much revenue as possible to dedicate to their charitable mission would price the products or services they offer at lower rates than the market would bear. See Brody, *supra* note 76, at 99–100; Colombo, *supra* note 110, at 529–31. While unfair competition concerns may be politically attractive arguments for anticommerciality rules in general, and UBIT in particular, the economic evidence does not tend to support them. See Colombo, *supra* note 110, at 530–31; Michael S. Knoll, *The UBIT: Leveling an Uneven Playing Field or Tilting a Level One?*, 76 *FORDHAM L. REV.* 857, 891 (2007) ("Under ordinary circumstances, the exemption from tax does not provide nonprofits with the ability to outbid their for-profit competitors for business assets."); Stone, *supra* note 109, at 1478. Professor Colombo also considers several other possible rationales for federal tax law's anticommerciality position, but concludes that none of these possibilities provide a robust defense of the current regime.

business in order to cover its costs—including employee salaries—there is real cause for concern.

Current charity law tries to separate true from disguised charities by examining the scope and manner in which a charity operates its commercial activities.²⁷⁷ This real concern can instead be addressed by stepped-up enforcement of charity law expressing the other-regarding orientation requirement. If salaries are excessive or other private payments are being made, this is prohibited inurement, excess benefit, or private benefit and likely a breach of fiduciary obligation. If profits are being sought simply to support these kinds of expenditures, the charity breaches the nondistribution constraint and other law and rules designed to implement the other-regarding orientation requirement. On the other hand, however, if commercial activities are undertaken to support a meaningful charitable program, this is a beneficial activity and should not be limited.

Undertaking commercial activities is a tactical decision about how to raise revenue, and sources of revenue for charities are limited and inadequate. A charity itself is best able to make the decision whether commercial activity will provide sufficient income to warrant taking on its attendant financial and opportunity costs and risks of distraction. It should make this decision through dialogue among its leaders and other constituencies involved in group governance. When a charity opts to engage in commercial activity, its need to earn a profit to support its mission-related programs will provide the necessary discipline for its decision. Charities' autonomy is what allows them to play their crucial role in civil society and to fill gaps in the market economy; it should be zealously guarded.²⁷⁸

A second serious concern about relaxing charity law's anticommmerciality rules questions whether doing so will seriously damage the public fisc.²⁷⁹ Times are tough and public budgets are always stretched thin. If for-profits in disguise move en masse from the taxable rolls to the exempt charity category, federal income tax revenues will decrease. Localities already perceive charitable exemptions to cause shortfalls serious enough that many have challenged them in court or negotiated payments-in-lieu-of-taxes with individual well-heeled charities.²⁸⁰ My proposal takes the measured form it does

277 See *supra* notes 90–98 and accompanying text.

278 But see Mayer, *supra* note 1, at 57–60 (arguing that the consumer influence may challenge the autonomy of a charity engaged in commercial activity).

279 See Stone, *supra* note 109, at 1491.

280 See Brody, *supra* note 43, at 658–65; Gallagher, *supra* note 7, at 14–16.

partly in order to deal with this concern, avoiding significant revenue implications and making it politically feasible.

Remember, this proposal would strike only the commerciality limitations blocking access to recognition and eligibility for tax-exemption under federal and state law. Charities would be freed from concerns that their revenue-generation decisions could cost them their *charity status* if they breached a notoriously vague limitation on “too much” or “too commercial” commercial activity. Yet, my proposal would leave other current anticommmerciality regimes firmly in place. It would not repeal UBIT.²⁸¹ It also would allow continuation of the longstanding practice of considering state property tax exemption on a per-parcel basis, based on a combination of exempt organization ownership *and* charitable use. Although charities would not be screened out of eligibility for tax exemption based on commercial activities, income streams from businesses or parcels devoted to non-charitable commercial uses could still be taxed. In each case, the proposal allows taxation of assets (either income or owned property) devoted to unrelated commercial activities,²⁸² but does not threaten the entity’s eligibility for charity status due to its decision to undertake them.

Taxation will, of course, still influence a charity’s decision whether to engage in unrelated commercial activities in order to earn revenue or to pursue funding by some other means, such as related commercial activities, donations, or grants. A rational charity will pursue unrelated commercial endeavors if and when the anticipated post-

281 In fact, I have sympathy with calls to repeal UBIT. It can be criticized as unhelpfully influencing charities’ internal decisionmaking along the lines described above. It is a very low revenue producing tax, the enforcement costs of which may well not be warranted. However, proposing the repeal of any revenue producing tax at this moment, if not anytime, makes the proponent too easy to disregard. See Colombo, *supra* note 110, at 547–56.

282 Notably, in the case of UBIT, defining the unrelated category is not solely about distinguishing truly charitable activities that produce income from more business-like activities. I believe the proposal would be improved, therefore, by incorporating the simplifying changes to UBIT proposed by Professor Colombo. These would remove the passive income and other exceptions in favor of applying the UBIT to all commercial activities of exempt organizations. Colombo’s proposal that UBIT be expanded to apply to all commercial activities seems, at first glance, to remove the relatedness criterion and therefore remove this level of government influence over charity decisionmaking as well. However, this proposal really just moves the relatedness question to differentiating “taxable commercial activities and nontaxable but revenue-producing ‘charitable’ activities.” Colombo, *supra* note 110, at 559. These would still need to be distinguished to avoid taxing universities’ tuition payments, for example. I would, therefore, happily adopt this sense of unrelated rather than the current UBIT regime’s definition.

tax revenue from them exceeds that from other potential revenue sources. Placing unrelated commercial activities on this footing as compared with other revenue-generating opportunities appropriately re-centers charity law on its roots in enforcing the mission imperative. Charity law should focus charities and their leaders on the need to serve mission, not micromanage their decisions about how to produce the revenue needed to do so.

D. Political Charity

The greatest challenge to charity law's exhortation that charities avoid politics comes from the actions charities themselves have taken to avoid these restrictions. Boldest among these actions have been direct legal assaults on federal restrictions on political activity, grounded on First Amendment and autonomy arguments.²⁸³ On the federal level, where one finds most of the law requiring that charities eschew politics, these challenges have been uniformly unsuccessful.²⁸⁴

²⁸³ Charities have challenged the federal law restrictions on their political activities virtually since their inception on both constitutional and public policy grounds. The ultimate word on the constitutional question came from the U.S. Supreme Court in *Regan v. Taxation with Representation of Washington*, 461 U.S. 540, 545–46 (1983). Taxation with Representation of Washington (TWR) was an organization that applied for exempt status under § 501(c)(3) to promote the “public interest” on taxation issues by publishing a journal, litigating cases, and lobbying. *See id.* at 543. Prior to the suit, TWR had used a dual structure, locating its publishing and litigation activities in a § 501(c)(3) entity and its lobbying in a separate affiliate organized under § 501(c)(4). *See id.* TWR consolidated all of these functions into a single organization and applied for (c)(3) exempt status, precipitating the case. *See id.* The IRS denied exemption to it on grounds that the organization failed the requirement that no substantial part of its net earnings be used for lobbying. *See id.* at 542. Among other things, TWR argued that the lobbying restriction placed an unconstitutional condition on its free speech as protected by the First Amendment. *See id.* at 545. The Court upheld the statute, with the plurality relying on the identification of the federal tax benefits for charities as a subsidy. The Court explained that although Congress cannot deny a benefit to a person on the basis of his exercise of a constitutional right, Congress need not subsidize protected activity. *See id.* at 545–46. Refusing to subsidize charities’ political activity thus simply did not count as an infringement or restriction on First Amendment free speech. *See id.* at 549.

Justice Blackmun’s concurrence provided the important fifth vote. He wrote separately to point out that he agreed with the majority if and on the assumption that the dual (c)(3)/(c)(4) structure remains available. *See id.* at 552–53. This structure ensures that exempt organizations may engage in lobbying without losing their exemption, but would prevent funding this activity with deductible contributions. *See id.* at 553; *see also supra* notes 125–29 and accompanying text.

²⁸⁴ *See, e.g.,* Legal Aid Soc’y of Haw. v. Legal Servs. Corp., 145 F.3d 1017, 1023–31 (9th Cir. 1998).

Some state law challenges have prevailed,²⁸⁵ but there are so few state-level restrictions on political activity that this offers charities with political aspirations little comfort.

In response, charities have taken more pragmatic steps to pursue the political activities they see as fundamental to pursuing their missions. Current charity law allows charities to engage in insubstantial political activity, and some charities do so. By electing special 501(h) status, more lobbying may be permitted, though it must be carefully tracked and reported. The dual and triad affiliated structures described above sanction significant interrelation and coordination between charitable and political entities, and even permit charities to provide some support for candidates.²⁸⁶ By blessing these structures, federal law has already allowed the idea that charities must eschew politics to be seriously undermined.

Of course, use of the § 501(h) and affiliated structure strategies will only be available to charities of a certain size and sophistication. They impose serious administrative burdens. Too, perhaps, they impose reputational costs, as charity law expresses the idea that charitable and political endeavor are incompatible. Together, these costs of affiliation will be insurmountable for many small, novel, or unorthodox charities. Yet, many charities clearly see political advocacy and even campaign activity as an important way to pursue their missions. Otherwise, they would not shoulder the cost (which cannot be funded through deductible contributions) to structure themselves in dual or triad forms and would not undergo the administrative pains required to maintain those structures or § 501(h) status.

Corporate foundations provide another example of how charities use affiliation to stretch the limits placed on them by federal tax law's restrictions on political activity. Due to their single funding source, corporate foundations almost always will be characterized as private foundations,²⁸⁷ which operate under separate and especially restric-

285 See, e.g., *New England Legal Found. v. City of Bos.*, 670 N.E.2d 152, 158 n.8 (Mass. 1996) (holding that an organization that engaged primarily in test-case litigation was charitable and not political, permitting it to retain property-tax exemption); *Mich. United Conservation Clubs v. Twp. of Lansing*, 378 N.W.2d 737, 743 n.6 (Mich. 1985) (finding the organization's lobbying activities would not bar its property tax exemption).

286 See *supra* notes 125–31 and accompanying text.

287 See I.R.C. § 509 (2006) (defining as private foundations any § 501(c)(3) exempt entity not qualifying as a traditional charity, such as a church, school or hospital, or receiving more than one-third of its support from the public, or as an organization supporting an entity fitting one of the prior two categories); see also IRS, PUBLICATION 557: TAX-EXEMPT STATUS FOR YOUR ORGANIZATION 27–43 (2008) (explaining the application of the tests for private foundation status in detail).

tive limits on political activity. The Internal Revenue Code lists amounts paid by private foundations for lobbying legislators or government officials directly, for expenditures to persuade members of the public to do the same, to influence elections, and even to carry on voter registration drives as taxable expenditures, and subjects them to penalty taxes.²⁸⁸ Corporate foundations, however, have a relatively easy way to avoid these significant restrictions. A sympathetic donor for-profit corporation may simply add the foundation's political agenda to its own government relations strategy.²⁸⁹

Here, as elsewhere, innovators also have used for-profit forms in order to sidestep charity law's restrictions. For example, the founders of Google.org explained their use of a for-profit model partly as a way to avoid restrictions charity law would place on political activities. Early explanations of its choice of form highlighted plans "to lobby for policies that support [its] philanthropic goals" as part of its rationale for choosing the for-profit philanthropy model.²⁹⁰ Google.org has not yet indicated any plans to participate in political campaigns, though its structure as a division of for-profit Google Inc. would give it ample flexibility to do so.

When compared with charities, the political activities of business entities are relatively unrestricted. Of course, campaign finance rules requiring contribution disclosures and registration of lobbyists can apply to business actors, as they do to all speakers.²⁹¹ The recent decision in *Citizens United v. Federal Election Commission*²⁹² removed some

288 See I.R.C. § 4945.

289 I thank Professor Garry Jenkins for this insight.

290 *Our Structure*, GOOGLE.ORG (formerly available at <http://www.google.org/about.html>) (on file with author); see also Strom & Helft, *supra* note 163 (noting Larry Brilliant's belief that Google.org's ability to lobby was one of its advantages). Another option is to incorporate offshore. See, e.g., Ian Wilhelm, *Atlantic Philanthropies Stakes \$25 Million on Health-Care Lobbying Group*, CHRON. PHILANTHROPY, Aug. 20, 2009, at 10 (describing avoiding political limitations as one reason for Atlantic Philanthropies' incorporation in Bermuda).

291 See, e.g., 2 U.S.C. § 441d (2006) (requiring disclosures of contributions to fund certain campaign advertisements); *id.* § 1603 (mandating lobbyist registration).

292 130 S. Ct. 876 (2010). Various scholars have now opined on the likely impact of *Citizens United* on political limitations imposed on federally tax-exempt charities. See, e.g., Ellen P. Aprill, *Regulating the Political Speech of Noncharitable Exempt Organizations After Citizens United* (Loyola Law Sch. L.A., Legal Studies Paper No. 2010-57, 2010), available at <http://ssrn.com/abstract=1727565>; Roger Colinvau, *Citizens United and the Political Speech of Charities* (December 17, 2010) (unpublished working paper), <http://ssrn.com/abstract=1726407>; Lloyd Hitoshi Mayer, *Charities and Lobbying: Institutional Rights in the Wake of Citizens United* (Note Dame Law Sch., Legal Studies Research Paper No. 10-39, 2011), available at <http://ssrn.com/abstract=1735010>.

previously existing limits on for-profit corporate speech, further widening the charity-business divide on this issue.

Court battles and affiliated structures of various kinds have long raised questions about the force and desirability of a strong division between charity and politics. Innovations blending charity and business models have added new pathways for charities who wish to opt out of the political restrictions. These efforts combine to create substantial pressure challenging the legal restrictions on charities' political activities. Again, charity law should relent.

Like in the anticommerciality context, the key issues are mission and autonomy. The United States and the world more broadly are political places. In order to achieve societal good and certainly to make any sort of meaningful change, some political action is often necessary. It does little good for charity law to define engagement with the political system as outside the proper charitable sphere. Doing so can force charities to be fundamentally less relevant to the civil society they are supposed to embody and less able to achieve the missions they are charged with pursuing.²⁹³ Doing so also encourages charities to create administratively complex organizations in order to engage in the political activities they see as crucial, to skirt the rules, or to opt out of charity status.

As much as possible, charity law's restrictions on political activity should be removed. Primarily, these will be federal tax law restrictions. To the extent that state organizational law and property tax law also condition charity status on refraining from political activity, these constraints should also be eliminated. Charities themselves are best situated to determine when political action will be useful in pursuing their missions. When political involvement is used as a mere subterfuge for pursuit of private purposes, the inurement, excess benefit, and private benefit doctrines, fiduciary obligation, and the nondistribution and charitable purpose requirements provide sufficient enforcement muscle for regulators. So long as charities remain committed to an other-regarding purpose and are structured to police this

293 See Alyssa Battistoni, *An Ounce of Advocacy*, STAN. SOC. INNOV. REV., Winter 2010, at 37 (arguing nonprofit advocacy is the best use of resources aimed to prevent and relieve disasters); Chisolm, *supra* note 137, at 241–44 (noting the arguments that the political restrictions steer nonprofits away from their view of their mission); see also LESLIE R. CRUTCHFIELD & HEATHER MCLEOD GRANT, *FORCES FOR GOOD* (2008) (arguing that combining service provision and political advocacy is the first of six practices identified with nonprofits that achieve especially great social impact); cf. Mayer, *supra* note 1, at 34 (arguing for a removal or relaxation of the lobbying restrictions on autonomy grounds, but favoring retention of the electioneering restrictions to avoid abuses of and by charities).

purpose through a strong group model, any other limits on charities' engagement with the political system should be imposed by the lobbying and election law limits seen fit to apply to other actors within it.

Of course, some will worry that the tax-deductible status of charitable contributions will lead to abuses beyond the reach of lobbying and election law. The federal tax prohibition on electioneering has been argued to dovetail importantly with broader election regulation, operating together to avoid such abuses.²⁹⁴ This suggests an important caveat to my proposals here. Charity law does not exist in a vacuum, but as part of the web of law regulating charities and other institutions engaged in charitable and noncharitable activities. Changes in charity law may, therefore, necessitate changes in other areas. If charity law's restrictions on political activity are relaxed in recognition of the fact that political activity in general, and participation in electoral campaigns in particular, can be an appropriate part of a charity's programs, other areas of law might need to change in response. But, regulating the potential for influence-peddling, bribery, or political distortions in these activities is a more appropriate task for lobbying or campaign finance laws than it is for charity law.

If removing charity law's political restrictions entirely is not politically feasible,²⁹⁵ alternative reforms should focus on restricting use of deductible contributions or exempt property rather than barring access to charity status. The current federal system opening political activity only to those organizations that can afford to structure themselves using complex dual or triad forms is not a sufficient solution. It disturbingly solves the problem of lack of political access only for those charities affluent and sophisticated enough to use these techniques.

CONCLUSION

Charity law can best promote mission accountability by focusing on two essential requirements: charities must maintain an other-

294 See Tobin, *supra* note 137, at 1339–42 (arguing that it would be extremely difficult to track deductible contributions if charities were permitted to engage in electioneering).

295 Intriguingly, there has been some recent political support for repeal or limitation of federal tax law's political restrictions on charities. A now-public staff memo to Senator Charles Grassley, Ranking Minority Member of the Senate Finance Committee, advocates removing or limiting the federal prohibitions on campaign activity by § 501(c)(3) exempt public charities "because the game is not worth the candle." Memorandum from Theresa Pattara & Sean Barnett to Senator Grassley, Re: Review of Media-Based Ministries 54-61 (Jan. 6, 2011), available at <http://finance.senate.gov/newsroom/ranking/download/?id=1f92d378-baa2-440d-9fbd-333cdc5d85fc>.

regarding orientation and must be governed by a group. The requirement that charities be other-regarding, not self-regarding, stems the possibility that charitable mission will be clouded by self-interest. The requirement that a charity must be controlled by a strong and diverse group, rather than by the vision of a single individual, provides a structure for articulating, evaluating and evolving mission internally over time.

Current charity law strongly asserts the other-regarding orientation requirement. However, rather than embracing the group governance norm, much of current charity law is taken up identifying, restricting, and penalizing charities' commercial and political activity. When focused on an other-regarding purpose and governed by a diverse group, charities themselves are better suited to determine when these categories of activity threaten mission, and when they are pivotal to carrying mission forward. Thus, charity law should be reformed to refocus on the other-regarding orientation and group governance requirements, excising restrictions on commercial and political activity where possible. Doing so will not only improve charity law's ability to regulate traditional charities, but will also give it the necessary tools to respond to the spate of recent innovations blurring the boundary between charity and business.

