NORTH CAROLINA LAW REVIEW

Volume 55 | Number 3 Article 14

3-1-1977

Taxation -- The Twilight Zone of Charity: The IRS Denies Exemption for a Free Tax Planning Service Under Section 501(c)(3)

Frank Lane Williamson

Loan Corp.[85] that exhibit extreme deference to legislative purpose are given credence, alternatives to the rule will warrant little consideration in the face of a rule replete with valid, justifiable objectives and the support of a vast majority of cases.

However, the deferential manner in which a court might deal with this issue should not preclude a reconsideration of the policy behind DR 7-109(C). It is apparent that in many instances the prohibition of the rule does render an injustice. If contingent payment to expert witnesses were tempered by requirements that the payment be reasonable and that there be full disclosure to the court, jury and opposing counsel, such agreements could be permissible.

Although the decision in *Person* has no further jurisdictional reach than the boundaries of the Eastern District of New York, it may spark the ABA and state bar associations to institute changes in DR 7-109 (C). Total revocation of the rule would inevitably lead to abuses of a privilege that should be reserved for exceptional situations. Retention of the rule and its arbitrary and categorical denial of expert testimony to those who cannot afford such testimony is itself an abuse of justice. Difficulty of administration should not prevent the amendment of a rule unyielding in its absolute denial of the only means an indigent plaintiff might have for obtaining fair treatment at trial.

MICHAEL A. HEEDY

Taxation—The Twilight Zone of Charity: The IRS Denies Exemption for a Free Tax Planning Service Under Section 501(c)(3)

The Internal Revenue Service (IRS) exercises a major influence over the development of public charities through its power to characterize an organization as "charitable" under section 501(c)(3)[1] of the

85. 337 U.S. 541 (1948); *see* note 84 *supra.*

1. I.R.C. § 501 provides in part:

(a) EXEMPTION FROM TAXATION.—An organization described in subsection (c) . . . shall be exempt from taxation . . . .

. . . .

(c) LIST OF EXEMPT ORGANIZATIONS. . . .

. . . .

(3) Corporations, and any community chest, fund, or foundation, organ-

Internal Revenue Code. An organization denied the protection of tax exempt status normally suffers a severe shortage of income since contributions given to it are not deductible as "charitable contributions" under section 170(c)(2).[2] Unless overruled by federal court decisions or congressional action, the IRS determines whether the activities of a particular organization should be supported by tax exempt public contributions. In Revenue Ruling 76-442[3] the IRS ruled that an organization that offers free personal tax planning services to those who wish to make charitable gifts is not operated exclusively for charitable purposes, and hence does not qualify as a 501(c)(3) organization. This restrictive ruling represents an overly narrow perception of the primary policy of section 501(c)(3), which is to encourage charitable giving and can be viewed as inconsistent with previous interpretations of the statute.

The organization discussed in Revenue Ruling 76-442 employed a staff of salaried attorneys to provide its services. It did not charge fees for its services although obviously its clients were generally not indigent. The organization derived most of its income from public contributions but was not affiliated with any particular charity or group of charities. Rather, it encouraged its clients to give to charities of their personal choice.[4]

The IRS focused on whether the organization could be considered to serve a public rather than a private interest[5] and concluded that in aiding individuals in tax planning the organization was providing a commercially available service to people who could afford it rather than a

---

ized and operated exclusively for religious, charitable, scientific, testing for public safety, literary, or educational purposes, or to foster national or international amateur sports competition (but only if no part of its activities involve the provision of athletic facilities or equipment), or for the prevention of cruelty to children or animals, no part of the net earnings of which inures to the benefit of any private shareholder or individual, no substantial part of the activities of which is carrying on propaganda, or otherwise attempting to influence legislation, (except as otherwise provided in subsection (h)), and which does not participate in, or intervene in (including the publishing or distributing of statements), any political campaign on behalf of any candidate for public office.

2. *See* 4 T. RABKIN & M. JOHNSON, FEDERAL INCOME, GIFT AND ESTATE TAXATION § 59.01(2), at 5903b (1976). The definition of organizations eligible to receive deductible charitable contributions found in § 170(c)(2) mirrors the language of § 501(c)(3) except that trusts are also eligible, the organization must be created in the United States or under United States law, and, curiously, "testing for public safety" is not mentioned.

3. 1976-46 I.R.B. 12.

4. *Id.*

5. *Id.* at 13 (citing Treas. Reg. § 1.501(c)(3)-1(d)(1)(ii) (1959), which provides: "An organization is not organized or operated exclusively for charitable purposes . . . unless it serves a public rather than a private interest.")

charitable activity in the legal sense.[6] This private purpose was held to be predominant although the public could benefit from funds being made available to charity as a result. The public benefit was thought to be tenuous; the fact that charitable gifts were contemplated in the plans drawn up could not transmute such services into a charitable activity.[7]

Case law and IRS ruling policy in this area must be understood against the common law background of charity. The federal tax laws have traditionally acknowledged that charities "lessen the burdens of government"[8] by providing what government might otherwise be obligated to perform. For this reason Congress has granted favored tax status to charities and charitable giving. In this respect the Code is no innovation; instead it generally incorporates the common law principles of charity[9] as developed mainly through the law of charitable

---

6. The IRS's working definition of "charitable" is found in its Regulations:

> The term "charitable" is used in section 501(c)(3) in its generally accepted legal sense and is, therefore, not to be construed as limited by the separate enumeration in section 501(c)(3) of other tax-exempt purposes which may fall within the broad outlines of "charity" as developed by judicial decisions. Such term includes: Relief of the poor and distressed or of the underprivileged; advancement of religion; advancement of education or science; erection or maintenance of public buildings, monuments, or works; lessening of the burdens of Government; and promotion of social welfare by organizations designed to accomplish any of the above purposes, or (i) to lessen neighborhood tensions; (ii) to eliminate prejudice and discrimination; (iii) to defend human and civil rights secured by law; or (iv) to combat community deterioration and juvenile delinquency.

Treas. Reg. § 1.501(c)(3)-1(d)(2) (1959). This definition includes some of the terms other than "charitable" found in § 501(c)(3). *See* note 1 *supra*. The Code should be understood as treating "charitable" as inclusive of these types of activities as well (since all of § 170(c) is under the heading of CHARITABLE CONTRIBUTION DEFINED), although the full meaning of charity is not exhausted by any checklist of activities. *See* Reiling, *Federal Taxation: What Is a Charitable Organization?*, 44 A.B.A.J. 525, 526 (1958).

7. 1976-46 I.R.B. at 12, 13.

8. The definition of "charitable" in the Treasury Regulations scarcely differs in substance from the classic definition formulated by Justice Gray of Massachusetts:

> A charity, in the legal sense, may be more fully defined as a gift, to be applied consistently with existing laws, for the benefit of an indefinite number of persons, either by bringing their minds or hearts under the influence of education or religion, by relieving their bodies from disease, suffering or constraint, by assisting them to establish themselves in life, or by erecting or maintaining public buildings or works or otherwise lessening the burdens of government.

Jackson v. Phillips, 96 Mass. (14 Allen) 539, 556 (1867). *See also* Statute of Charitable Uses, 1601, 43 Eliz. 1, c. 4.

9. *See* Treas. Reg. § 1.501(c)(3)-1(d)(2) (1959), *quoted in* note 6 *supra* ("The term 'charitable' is used . . . in its generally accepted legal sense . . . ."); Reiling, *supra* note 6, at 526; Thrower, *IRS is Considering Far Reaching Changes in Ruling on Exempt Organizations*, 34 J. TAX. 168 (1971); *cf.* Green v. Connally, 330 F. Supp. 1150, 1157 (D.D.C.), *aff'd*, 404 U.S. 997 (1971) (" 'strong analogy' can be derived from the general common law of charitable trusts, at least for close interpretive questions"). *But cf.* Faulkner v. Commissioner, 112 F.2d 987, 992 (1st Cir. 1940) ("Interpretation of the word 'charitable' in a federal revenue act is a matter of federal, not local, law.").

trusts. These flexible common law principles allow great latitude for diverse organizations to be brought within the ambit of section 501(c)(3). These very characteristics of flexibility and generality, however, inhibit the development of concrete guidelines for eligibility under the exemption and result in a certain inconsistency of interpretation.[10] Court decisions and revenue rulings often fulfill a rulemaking function only by default. While organizations factually similar to organizations previously ruled upon are likely to be analyzed and treated similarly, articulable rules can be discerned only with difficulty. This result is attributable to the inherently amorphous character of any conception of what is charitable.

Another factor that further hampers the emergence of precise rules is the frequent mandate from the federal courts that the charitable exemption and deduction statutes, unlike other tax statutes, should be liberally construed in the favor of the taxpayer in order to encourage charitable activity. According to Judge Augustus Hand:

> The policy of exempting these [charitable] corporations is firmly established and has been continuously expanding ever since the system of income taxation was adopted. The statute [predecessor of section 501] should be read, if possible, in such a way as to carry out this policy and not to make the result turn on accidental circumstances or legal technicalities.[11]

In place of "legal technicalities" the courts and the IRS have closely scrutinized proffered charitable activity in order to decide whether its particular factual characteristics comport with abstract notions of what is "religious, scientific, [or] educational . . . ." A broad construction of such charitable categories will generally result in an expansive reading of section 501(c)(3).

One common touchstone that underlies this scrutiny and serves as a prerequisite for a finding of charitability is the extent to which an activity is conducted for the public benefit.[12] There are two aspects

10. *See* Reiling, *supra* note 6, at 525. In a sense it is fortunate that rigid rules have not crystallized. Otherwise, the creative process of founding new types of charitable activity might be curbed, or at least shunted into certain prescribed directions. A Commissioner of the IRS once recognized the growth of innovative types of charitable organizations. Thrower, *supra* note 9, at 168.

11. Slocum v. Bowers, 15 F.2d 400, 403 (S.D.N.Y. 1926), *aff'd*, 20 F.2d 350 (2d Cir. 1927). *See also, e.g.*, United States v. Pleasants, 305 U.S. 357, 363 (1939); Helvering v. Bliss, 293 U.S. 144, 150-51 (1934); Threlfall v. United States, 302 F. Supp. 1114, 1118 (W.D. Wis. 1969).

12. The Code does not use the term, but it is implicit in Gray's definition of charity as being "for the benefit of an indefinite number of persons." *See* note 8 *supra*. The Regulations specify that a charitable organization must serve "a public rather than a private interest." Treas. Reg. § 1.501(c)(3)-1(d)(1)(ii) (1959).

to this inquiry in the context of section 501(c)(3): on the one hand, an activity must be "public" in that it benefits an indefinite number of persons[13] rather than ascertainable individuals,[14] while on the other, it must be of "benefit" to the community.[15] Such a concept as "public benefit" is of dubious utility without examination of those factual patterns where public benefit has necessarily been found by virtue of the granting of the exemption.[16] Difficult cases arise where any perceived public benefit is indirect or tenuous, as when some of the organization's activities are clearly not charitable. Examples of these problems are readily found in the treatment of legal or law-related organizations. The facts that the advocacy element associated with traditional legal services often injects an aspect of personal benefit into the activity and that legal services cannot be easily placed in the separately enumerated charitable categories give rise on occasion to strained apologia for findings of public benefit. The legal aid society that provides free services to indigent persons who could not otherwise afford them is a type of legal service organization that readily qualifies under traditional notions of charity. This sort of activity is clearly subsumed under charity in its most popularly understood guise, expressed in the IRS's definition as "[r]elief of the poor and distressed or of the underprivileged."[17] Accordingly the IRS has always held such organizations to be exempt.[18]

---

13. *See* note 8 *supra*; Estate of Carolyn E. Gray, 2 T.C. 97, 103 (1943). The class to be directly benefited need not encompass the entire public. It is enough that the community benefits by the aid given to the class. *Id.*

14. This also proscribes individuals from profiting by operating the organization. The provision in § 501(c)(3) requiring that "no part of the net earnings of which inures to the benefit of any private shareholder or individual" expresses this principle. *See* Treas. Reg. § 1.501(c)(3)-1(d)(1)(ii) (1959). Payment of reasonable salaries, however, does not violate the inuring doctrine. Mabee Petroleum Corp. v. United States, 203 F.2d 872, 876 (5th Cir. 1953).

15. The statute states that an organization must be "organized and operated exclusively for . . . charitable . . . purposes." In actual practice this is satisfied by being "primarily" or "dominantly" charitable. *See* Treas. Reg. § 1.501(c)(3)-1(c) (1959); Passaic United Hebrew Burial Ass'n v. United States, 216 F. Supp. 500, 505 (D.N.J. 1963). It is more difficult to reach a consensus on the meaning of "primarily" in a given situation than on "exclusively." This gloss on the wording of the statute serves to add confusion to uncertainty. *See* Keir, *What is a Charity: Statutory Definition; Exclusively; Lobbying*, in N.Y.U., PROCEEDINGS OF FOURTEENTH ANN. INST. ON FED. TAX. 19, 22 (H. Sellin ed. 1958). "The basic question, however, as to the 'primary' purpose of an organization is factual and not always of simple solution." *Id.*

16. *Cf.* Goldberg & Cohen, *Does Higher Authority than IRS Guidelines Exist for Public Interest Law Firms?*, 34 J. TAX. 77 (1971) (the phrase "broad public interest" adds little to case law or policy); Reiling, *supra* note 6, at 595 (whether the public interest is served by an exemption is a matter of generally accepted opinion).

17. Treas. Reg. § 1.501(c)(3)-1(d)(2) (1959).

18. Rev. Rul. 69-161, 1969-1 C.B. 149. It is also considered charitable for a legal

In Revenue Ruling 72-559[19] the IRS granted exempt status to a legal aid society whose means clearly had personal benefit aspects, but that were subsidiary to an overall charitable purpose. There the purpose was to provide free legal services to low income residents of economically depressed communities through subsidizing recent law school graduates who were willing to commit themselves to such work. The IRS ruled that although the organization provided professional training and a salary to the interns, who were not themselves members of a charitable class, the organization's principal purpose remained charitable in view of the fact that the interns were to be the instruments through which the charitable purpose was to be accomplished.[20] This ruling thus stands for the proposition that personal benefit to individuals, which is not of itself charitable, will not preclude a finding of a primarily charitable purpose if the personal benefit is necessary for the accomplishment of the charitable objectives.[21] A charity may work through indirection; a noncharitable activity may induce further activity which is charitable—all for an overriding resultant charitable purpose.

Such circuitous public benefit has also been found in the operation of law libraries and the activities of bar associations. In *United States v. Proprietors of Social Law Library*[22] an organization was held to be charitable as furthering an educational purpose even though use of the law library that it operated was confined to dues-paying subscribers and though law students were excluded altogether. The First Circuit addressed itself to the fact that the specialized learning offered by a law library is not itself directly useful to the general public. It found indirect public benefit by reasoning that the opportunity for research in the law by those in a position to affect or apply an understanding of it helps to strengthen those principles of law on which government

---

aid society to post bail or pay bondsmen's fees for indigent persons accused of crimes. Rev. Rul. 76-21, 1976-3 I.R.B. 5; Rev. Rul. 76-22, 1976-3 I.R.B. 6.

19. 1972-2 C.B. 247. The organization trained young lawyers, set them up in practice and compensated them for three years. During this time they were required to perform free legal services, and after three years were expected to have their own paying practice and to devote a substantial amount of time to providing free legal services to low income residents.

20. *Id.*

21. An alternative analysis could have been that subsidizing the interns was equivalent to paying reasonable salaries to employees and hence did not violate the inuring doctrine. *See* Mabee Petroleum Corp. v. United States, 203 F.2d 872, 876 (5th Cir. 1953).

22. 102 F.2d 481 (1st Cir. 1939).

rests—a process vital to the public at large.[23] Self interest is even more obvious and the finding of public benefit more strained in the cases dealing with bar associations, *Dulles v. Johnson*[24] and *St. Louis Union Trust Co. v. United States*,[25] in which charitable deductions for contributions to such organizations were upheld under the estate tax analogue of section 170(c).[26] In each case, while some of the association's activities were clearly charitable (*e.g.*, publishing legal articles, extending legal services to the poor, educating laymen on the law), others such as regulating the unauthorized practice of law, disciplining the profession, and advocating legislation, presented the issue of whether the bar associations were primarily protecting their own commercial interests. Both courts found the regulatory function of the bar associations to be in the public interest in the sense of helping to preserve the integrity and competence of the legal profession, which serves the public and in whom the public places its trust.[27] *Union Trust* also found that the social activities sponsored by the bar association, while not in themselves charitable, were only incidental to the other charitable activities.[28]

---

23. *Id.* at 484; *accord*, Rev. Rul. 75-196, 1975-1 C.B. 155, which also points out that the fact that users may derive personal benefit is just a logical by-product of the educational process. The court also stressed the library's directly educational purpose in that not only law books, but also books on government, history, and other general interest topics were included, and that the class of beneficiaries was not small or closed in that membership was open to others besides members of the bar. 102 F.2d at 483.

24. 273 F.2d 362 (2d Cir. 1959), *cert. denied*, 364 U.S. 834 (1960).

25. 374 F.2d 427 (8th Cir. 1967).

26. I.R.C. § 2055(a)(2).

27. 273 F.2d at 365-66; 374 F.2d at 436. "We think the government overemphasizes the incidental economic benefits and unjustifiably would taint with an accusation of commercialism legal activity which is dedicated to the public good." *Id.* at 435. Moreover, the court in *Dulles* found that what the bar association did in attempting to influence legislation was not the "attempting . . . to influence legislation" proscribed by § 2055(a)(2) since it was only directed to form, clarity of expression, and the legislation's relation to other law, rather than to the serving of any selfish motive. 273 F.2d at 367.

28. 374 F.2d at 438. *Dulles* and *Union Trust* may serve to illustrate that a finding of public benefit may be as much an assumption as a conclusion. A given set of ambivalent facts can be made to support either a positive or a negative finding depending upon which aspect—public or personal—a court places its emphasis. The holding in *Union Trust*, however, is tempered by an acknowledgement that each case turns on its facts and that some bar associations might not qualify. 374 F.2d at 440. The IRS has expressed its disapproval of these cases in denying § 501(c)(3) status to a bar association and will not use them as precedents for exemption questions under this section. Rev. Rul. 71-505, 1971-2 C.B. 232. Bar associations do qualify as exempt "business leagues" under § 501(c)(6). *Id.* In the above ruling the IRS found such activities as promulgating minimum fee schedules, directing programs aimed at making the practice of law more profitable, and sponsoring social activities to be "substantial" noncharitable purposes. This demonstrates that—as in the public-private benefit distinc-

A recently developed form of legal services organization to which the IRS has granted exempt status is the public interest law firm. The requisite public benefit[29] derived from the features that distinguish this type of law firm from an ordinary commercial law firm. To qualify, such firms must pursue the interests of the public (such as environmental issues or governmental abuses) in such a form that there is no direct representation of the private financial interest of individual clients (as through class actions or injunctions against government).[30] Furthermore they may neither solicit nor accept attorneys' fees from clients.[31] The exemption is denied if a public interest firm too closely resembles a commercial firm.[32] Practically, this means that aside from having to refuse fees, the firm must also ordinarily accept work only when the individual interests are so diffuse that commercial firms would find it economically unfeasible to accept the case.[33]

Another form of indirectly charitable activity that does not involve legal services per se is assistance to charitable organizations for the purpose of facilitating their charitable activities. These services are of indirect public benefit in the sense that only charitable organizations are directly served, but the public at large benefits from the resultant increase in efficiency of the charities so served. Otherwise these activities are closely akin to ordinary commercial services. In Revenue Ruling 69-572[34] an organization formed to construct and maintain a facility to house member agencies of a community chest (all of which were exempt under 501(c)(3)) was granted exempt status.[35] The

---

tion—the line between "substantial" and "incidental" is one more of emphasis than substance.

29. This activity is charitable not because the viewpoints it may advance are necessarily the most auspicious for the public as a whole, but because it helps to illuminate the issues of significant public interest that might otherwise be ignored. Rev. Rul. 75-74, 1975-1 C.B. 152, 153. *See generally* Goldberg & Cohen, *supra* note 16; Note, *The Tax-Exempt Status of Public Interest Law Firms*, 45 So. CAL. L. REV. 228 (1972).

30. Rev. Proc. 71-39, 1971-2 C.B. 575, 576 (guidelines for issuing advance ruling of exemption to public interest law firms).

31. Rev. Proc. 75-13, 1975-1 C.B. 662 (amplifying Rev. Proc. 71-39). They may, however, accept out-of-pocket expenses or court-awarded fees from opposing parties. *Id.*

32. *See* Rev. Rul. 75-75, 1975-1 C.B. 154, which denied an exemption to a firm that charged and accepted attorneys' fees when clients were willing to pay. The fees never exceeded actual costs and were much less than those charged by commercial firms.

33. *See* Rev. Rul. 75-74, 1975-1 C.B. 152, 153.

34. 1969-2 C.B. 119.

35. What distinguished this organization from an ordinary landlord was that rental income was only equivalent to operating costs (significantly below the fair market value

provision of this facility was judged to further a charitable purpose by encouraging coordination among the member agencies and aiding the more efficient use of their labor resources, thus enhancing the performance of their respective charitable functions.[36] A comparable aid to charity is the management or consulting service. In Revenue Ruling 71-529[37] an organization formed to help 501(c)(3) charities manage their funds more effectively was held to be performing a charitable function itself.[38]

Against this background, those attributes of the organization in Revenue Ruling 76-442 that would tend to obstruct a finding of charitability are readily apparent. The essential reason for the negative finding appears to be the refusal by the IRS to recognize the indirect public benefit of increased charitable giving derived from the tax counseling services. As pointed out above, when an activity serves both a private and a public interest, the conclusion as to which "predominates" is largely a matter of emphasis.[39] As in the bar association and law library cases,[40] individuals may receive a direct benefit, but that does not necessarily preclude a finding that an indirect public benefit overbears the significance of the private benefit.

A narrow focus upon the act of tax planning or even of giving, independent of the ultimate charitable use of the funds, would support a finding that the organization's activity is not directly charitable. Nevertheless, tax planning directly facilitates charitable activity through

---

of comparable office space) and that certain amenities were provided, such as a large central meeting room for the free use of the lessees. *Id.*

36. *Id.* "The performance of a particular activity that is not inherently charitable may nonetheless further a charitable purpose. The overall result in any given case is dependent on why and how that activity is actually being conducted."

37. 1971-2 C.B. 234.

38. The fact that the organization was controlled directly by a membership composed of exempt colleges and universities, was funded by capital received from these institutions, and charged fees to its members of less than 15% of cost, distinguished its service from that of a commercial consulting firm. *Id.* Other organizations providing similar services, however, have been denied exemption as being too akin to a trade or business. Rev. Rul. 69-528, 1969-2 C.B. 127. One basis of the denial was that if a tax exempt organization performed such a service on a fee basis it would result in taxable unrelated business income. *Id.* at 128. This infirmity was not overcome even when the services were provided at cost and exclusively for exempt organizations. Rev. Rul. 72-369, 1972-2 C.B. 245.

39. *See* note 27 *supra.* The IRS's position in the instant ruling that "[a]lthough funds may ultimately be made available to charity as a result of the organization's planning assistance to individuals, the benefits to the public are tenuous in view of the predominately private purpose served by arranging individuals' tax and estate plans" betrays this tacit bias. Rev. Rul. 76-442, 1976-46 I.R.B. at 13.

40. *See* notes 22-28 and accompanying text *supra.*

serving a middleman function of bringing contributor and charitable organization together. This function is analogous to that of those organizations such as the consulting service and the landlord whose charitable purposes are to promote the efficiency of other charitable organizations[41] and are thus inextricably intertwined and dependent upon the existence of other organizations' charitable activities.[42]

The direct benefit to the individual client derived from the organization's services should not of itself preclude a finding of charitability. Directly apposite on this point is the ruling granting exemption to the legal aid society that subsidized legal interns in order that they might provide free legal services to the indigent. There, the IRS stated:

> The fact that recipients of the organization's financial assistance, the legal interns, are not themselves members of a charitable class does not mean the organization is not operating primarily for charitable purposes. The interns are merely the instruments by which the charitable purposes are accomplished. Therefore, the fact that they derive personal gain from the arrangement does not detract from the organization's charitable purposes.[43]

In the instant ruling the individual clients are analogous to the interns. Since they are the contributors to charity, they are the indispensable "instruments" for accomplishment of the charitable purpose of making more funds available for charitable use. Without some support (*i.e.*, personally advantageous tax planning) it is likely that they could not be induced to give as much or at all to charity. The fact that clients *could* afford legal tax planning services (whereas young lawyers could not afford to work for free without starving) should not necessarily mean that free tax planning is not indispensable to the furthering of the organization's eleemosynary purpose. It is probable that high income taxpayers who would make charitable gifts as part of their estate and tax plans in any case would not avail themselves of this service, but would instead utilize private firms. When large deductions hinge on reliable tax advice high income taxpayers are likely to place their trust in the commercial services of the tax bar rather than in free legal services. The middle income taxpayers who have a desire to contribute to charity, however, may be deterred from doing so if they have

41. *See* notes 34-38 and accompanying text *supra.*

42. Perhaps "meta-charitable" would be an apt description of this function. This should be distinguished from the charity that dispenses funds through a second tier of foundations and the non-exempt § 502 "feeder organization," which distributes its profits to exempt § 501 organizations.

43. Rev. Rul. 72-559, 1972-2 C.B. at 247-48; *see* text accompanying notes 19-21 *supra.*

to retain high priced counsel in order to take advantage of the inducements that the tax law provides for charitable giving.[44]

The IRS perhaps unduly emphasized the assumed ability to pay on the part of the organization's clients in concluding that the "commercial" nature of the service taints any charitable purpose.[45] Whether an activity is "commercial" and hence noncharitable entails a broader inquiry than payment by clients, even though otherwise charitable organizations, such as a public interest law firm[46] and a charitable consulting service,[47] have been disqualified solely for receipt of fees. For instance, the IRS distinguishes public interest law firms from commercial law firms not only because they accept no fees, but also because they perform work that commerical law firms ordinarily do not.[48] Commerical law firms routinely engage in estate and tax planning on a profitable basis. In addition, tax planning in its most immediate context benefits only the individual, not the public. Since any individual in a position to avail himself of such services is almost certainly not indigent, the organization could not be said to benefit the class of the "poor and distressed" as the legal aid organization does in providing admittedly ordinary legal services.[49]

Nevertheless, if the tax counseling organization's services would for the most part be sought by those who would not otherwise seek to retain tax counsel, then the argument that this service is "commercial" is somewhat specious. The services performed by legal aid societies are also obtainable from ordinary law firms, but that fact alone does not render them commercial. What the IRS seems legitimately concerned with in Revenue Ruling 76-442 is not so much that a benefit may inure to those who operate the service if payment is accepted, but rather that its clients will abuse the service by obtaining free advice and at the same time deduct any fees they might choose to pay[50] for

44. In this respect, the provision of legal services for the middle income class of citizens, who are in general not well provided for by the legal profession, could be viewed as a directly charitable activity, though as yet there is no precedential support for this proposition.

45. "The organization is providing commercially available services to individuals who can afford them." Rev. Rul. 76-442, 1976-46 I.R.B. at 13.

46. *See* note 32 *supra.*

47. *See* note 38 *supra.*

48. *See* notes 29-33 and accompanying text *supra.*

49. *See* notes 17-21 and accompanying text *supra.*

50. The ruling does not state that the organization does in fact accept fees for service. Nevertheless, the statement that it "does not require any payment for its services" implies that it does not refuse such payment. Rev. Rul. 76-442, 1976-46 I.R.B. at 12.

these services as "charitable contributions" under section 170. Taxpayers would be obtaining a deduction for learning how to obtain deductions, a situation that would understandably displease the IRS. Section 170 itself, however, is sufficient to prevent this undue advantage even if the instant organization were granted exemption under section 501(c)(3).

Since the definition of "charitable contribution" in section 170(c) almost precisely parallels section 501(c)(3),[51] any deduction allowed under section 170 must a priori be to an organization qualifying under section 501(c)(3). Therefore, all of the considerations germane to the latter section are encompassed by section 170 as well, with the additional requirement that the proffered contribution not be made with the expectation that the donor will receive a consideration for his payment. The concept of public benefit permeates section 170 as well: a payment made for the receipt of a personal benefit precludes the contribution from being charitable. The test is objective, centering not on the donor's subjective intent, but rather on what he actually receives for what he pays.[52] The characterization of the payment made by the donor or the donee is not determinative. If the benefits to the contributor are not "substantial" then the deduction is allowed for the reason that the benefits flowing to the public offset the benefits flowing to the contributor.[53]

An example of this categorization process is provided by *Oppewal v. Commissioner*,[54] in which a taxpayer's contributions to a religious education society that operated a school supported entirely by public contributions were held to be nondeductible when the taxpayer's children attended the school.[55] The First Circuit reasoned that the payments should be regarded in substance as tuition since such payments, though not required, served the same function as tuition in supporting the operation of the school. This focus upon value allows those contributions that are in excess of the fair market value of the consideration received to be deductible to the extent of the excess.[56]

---

51. *See* note 2 *supra*.

52. Crosby Valve & Gage Co. v. Commissioner, 380 F.2d 146, 146-47 (1st Cir.), *cert. denied*, 389 U.S. 976 (1967).

53. Singer Co. v. United States, 449 F.2d 413, 423 (Ct. Cl. 1971).

54. 468 F.2d 1000 (1st Cir. 1972), *noted in* 8 SUFF. L. REV. 349 (1974).

55. *Id.* at 1002. See DeJong v. Commissioner, 309 F.2d 373 (9th Cir. 1962), for another school contribution qua tuition case.

56. *See* Rev. Rul. 67-246, 1967-2 C.B. 104 (deductibility of payments in connection with participation in fund-raising activities for charity).

The IRS would clearly be justified under this judicially developed principle of section 170 in disallowing deductions by the Revenue Ruling 76-442 organization's clients for their donations to the extent the value of the donations equals the cost of comparable tax planning services. This action would substantially exorcise those dimensions of commercialism and private benefit to which the IRS objected. Such an approach would have been preferable to denying 501(c)(3) status altogether, for the prior decisions and policy of section 501 would support a finding by a federal court that the organization qualifies for the exemption. Section 501 as manipulated in Revenue Ruling 76-442 is simply too blunt an instrument for use in deterring individual taxpayers from utilizing the charitable exemption as a subterfuge by which otherwise nondeductible personal legal expenses are transformed into charitable gifts. Section 170 could accomplish this result more directly and with more finesse. Such an alternative approach would permit the organization to continue to pursue its purpose of encouraging gifts to charity without imposing a tax burden of atonement on the organization itself for the possible sins of its clients.

FRANK LANE WILLIAMSON

Zoning—Arlington Heights v. Metropolitan Housing Development Corp.: An Implicit Endorsement of Exclusionary Zoning?

In recent years there has been considerable uncertainty in the federal courts about the precise nature of the equal protection standards applicable to cases of allegedly exclusionary zoning.[1] Lower federal

1. *See* Sager, *Tight Little Islands: Exclusionary Zoning, Equal Protection, and the Indigent*, 21 STAN. L. REV. 767, 799-800 (1969). *Compare* Comment, *Challenging Exclusionary Zoning*, 10 RICH. L. REV. 646, 686 (1976) (courts will apply rational basis test, so challenge will usually fail) *and* Comment, *Does a Zoning Ordinance with Racially Discriminatory Effects Violate the Constitution? Metropolitan Housing Development Corporation v. The Village of Arlington Heights*, 7 LOY. CHI. L.J. 141, 157 (1976) ("steadily expanding limits of the equal protection clause of the fourteenth amendment have now infringed on the formerly solid police powers of local governments to determine land use") *with* Note, *Challenging Exclusionary Zoning: Contrasting Recent Federal and State Court Approaches*, 4 FORDHAM URB. L.J. 147, 157 (1975) (ordinance that perpetuates residential segregation likely to fall, as federal court will apply strict scrutiny test).