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Charitable Endowments and the
Democratization of Dynasty

Evelyn Brody

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CHARITABLE ENDOWMENTS AND THE DEMOCRATIZATION OF DYNASTY

Evelyn Brody*

And so the house came to be haunted
by the unspoken phrase: *There must be more
money! There must be more money!*¹

News stories inform us that baby boomers are about to enjoy a "\$10 trillion transfer" from their aging parents. College and university fund raisers salivate over the prospect of reaping a significant share. The *Los Angeles Times* reported: "Those fund-raising machines are going to be running at high speed for the next twenty years or so. The reason: The timing will be right for an aging segment of society to be parting with its money.... [The universities'] prime target is wealthy people without children."² One goal is to build endowment.³ Many

* Assistant Professor of Law, Chicago-Kent College of Law. This work was supported by the Marshall D. Ewell Research Fund at the Chicago-Kent College of Law, and benefited greatly from my discussions with Fred Bosselman, Elizabeth Brody, Richard Epstein, Peter Dobkin Hall, Henry Hansmann, Adam Hirsch, Jill Horwitz, D. Bruce Johnsen, Margaret M. Mahoney, Gerald D. Scherr, Jack B. Siegel, John G. Simon, and Burton Weisbrod, as well as attendees at workshops at George Mason University School of Law and at the Institute for Policy Research, Northwestern University. I am grateful to Spencer Simons, librarian at Chicago-Kent College of Law, and that tremendous charitable resource, the Inter-Library Loan system.

1. D.H. Lawrence, *The Rocking-Horse Winner*, in *THE LOVELY LADY* 63, 64 (Martin Secker, London ed., 1932).

2. J. Michael Kennedy, *Colleges Target Aging Rich in Huge Fund-Raising Drives*, L.A. TIMES, Nov. 14, 1994, at A1 (University of California at Berkeley begins a \$1 billion capital campaign; Harvard seeks \$2 billion); see also Thomas B. Murphy & Paul G. Schervish, *The Dynamics of Welfare Transfer: Behavioral Implications of Tax Policy for the \$10 Trillion Transfer*, in 1995 INDEPENDENT SECTOR WORKING PAPERS 571 (citing a study of the 1993 Federal Reserve Wealth Data by Cornell University researchers).

3. For example, the University of Southern California, hoping to double its endowment by the year 2000 through fund raising and investment, has earmarked more than half of its \$1 billion capital campaign to endowment. *USC Announces Billion-Dollar Campaign; Funds Will Implement Strategic Plan for World-Class University*, BUS. WIRE, Sept. 15, 1995, available in LEXIS.

educational institutions, of course, already possess significant endowments. In the fall of 1996, Harvard's reached \$9 billion.⁴ Yet Harvard is in the midst of a \$2.1 billion capital campaign.

Other charitable institutions also are intent on growing their endowments.⁵ Nonprofits without endowments crave one. Professional advice on the strategic and tactical aspects of endowment building abounds in fund-raising circles.⁶ Every organization's capital campaign literature describes the plans it has for the endowment income. But the stampede to build endowment rarely is accompanied by an explanation of *why expenditures should be limited to income from endowment*.⁷ Desperately needing 5%, why not spend 10%? Why not 50%, or even 100%?⁸

AIDS research organizations present the debate most starkly.⁹ One group hopes to build a \$100 million endowment:

"It's essential for AIDS service organizations to create traditional annual funding campaigns, with traditional endowment programs.... Not to do this is like an individual not saving money, not creating a retirement plan.... What happens if there's a

4. Andrew Bary, *Harvard's Men*, BARRON'S, Dec. 2, 1996, at 31, 36 (cover story).

5. The Art Institute of Chicago recently trumpeted that its latest fund-raising campaign brought in \$6 million above its \$55 million goal; "the campaign's primary purpose was to obtain \$41.5 million of vitally important endowment." Art Inst. of Chicago, NEWS AND EVENTS, July/Aug. 1996, at 16. A fund-raising brochure had declared that its "mission is to be open to all,...and to contribute to the preservation and advancement of civilization through the presentation and teaching of art.... The Second Century Fund...must be understood as the most important, most urgent support program ever launched on the Art Institute's behalf." ART INST. OF CHICAGO, SECURING CHICAGO'S MASTERPIECE 10 (Winter 1996).

6. See, e.g., Kim Klein, *Thinking of Starting an Endowment?*, GRASSROOTS FUNDRAISING J., Aug. 1995, at 3; Margaret Currie, *Inside the Harvard Campaign*, NAT'L SOC'Y OF FUND RAISING EXECUTIVES: ADVANCING PHILANTHROPY, Winter 1994, at 41.

7. For a thoughtful trade analysis, see Stephen G. Green & Grant Williams, *A Question of Saving or Spending: Charities Say Cash Reserves Insure Their Continued Survival, but Critics Worry that Donors Are Being Mised*, CHRON. PHILANTHROPY, Apr. 18, 1996, at 1. See also Marianne G. Briscoe, *Is an Endowment Justified?*, NONPROFIT TIMES, Mar. 1994, at 10; Richard S. Linzer, *The Other Side of the Coin: A Closer Look at Endowments and Their Alternatives*, CHRON. NON PROFIT ENTERPRISE, Sept. 1989, at 4.

8. As long ago as the 1920s, the pioneer of professional fund raising for universities had declared, "[h]igh costs made the endowments of college of less and less value. Those institutions had to have money." SCOTT M. CUTLIP, FUND RAISING IN THE UNITED STATES 254-55 (1965) (quoting an address given by John Price Jones to the Association of Alumni Secretaries on April 13, 1923).

9. Cf. NACUBO EXECUTIVE BRIEFING PAPER: ENDOWMENT MANAGEMENT 8 (1991) [hereinafter NACUBO, ENDOWMENT MANAGEMENT] ("A popular gift to medical colleges in the first half of the 20th century was a term endowment to support research to develop a vaccine for polio"; once a vaccine was developed, the institution could spend the principal as it wished.).

depression in this country, or a recession, and people don't want to go to special events and pay \$500 a ticket?"¹⁰

Another AIDS organization hopes that an endowment will reassure wealthy donors of the group's financial stability.¹¹ Other groups disagree, because "[m]ajor donors want to see their money put to work."¹² As a compromise, one organization is creating a \$2 million reserve rather than an endowment.¹³

Over the last millennium of Anglo-American philanthropy, perpetual endowments have only sporadically proved controversial. More commonly, the public views the income-only fund as a positive, if not the superlative, form of conducting charity. Wilbur K. Jordan's monumental study of newly secularized philanthropy in England concluded with great satisfaction that over 80% of charitable contributions made between the years 1480 to 1660 went to endowments.¹⁴ Victorian reformer Courtney Kenny observed (although to his dismay):

We shall be prepared to find endowed charities ranked by common consent amongst the noblest of human works, the praise of Founders the theme of the historian's most glowing pages, and the preservation and extension of these monuments of far-seeing piety the sedulous object of the jurist and the politician.¹⁵

10. Paul Demko & Domenica Marchetti, *AIDS Groups Dig In for Long Haul*, CHRON. PHILANTHROPY, July 25, 1996, at 1, 24–25 (quoting Earl Katz of AIDS Project Los Angeles).

11. *Id.* at 25 (describing the Mobile AIDS Support Services in Alabama).

12. *Id.* (quoting Jim Graham, director of the Whitman-Walker Clinic in Washington, D.C.); see also Ernest Tollerson, *Charities Debate Tactic to Limit Gifts' Life Span*, N.Y. TIMES, Dec. 19, 1996, at B12 ("[Irene] Diamond's most famous philanthropic wager involved investing \$25 million to create the Aaron Diamond AIDS Research Center," at which its director, Dr. David D. Ho, made important discoveries; "[h]ad Mrs. Diamond behaved more conventionally, giving away \$7 million or so a year, creation of the laboratory would have been stalled for years while the foundation searched for partners, said Vincent McGee, the foundation's executive director.").

13. Demko & Marchetti, *supra* note 10, at 25 (describing the Gay Men's Health Crisis in New York City).

14. W.K. JORDAN, PHILANTHROPY IN ENGLAND, 1480–1660: A STUDY OF THE CHANGING PATTERN OF ENGLISH SOCIAL ASPIRATIONS 118 (1959); see also *id.* at 24 (acknowledging that many small gifts and informal charity eluded his research). Moreover, endowed institutions could also be found in pre- and non-Christian societies. See MARION R. FREMONT-SMITH, FOUNDATIONS AND GOVERNMENT 14–16 (1965). My Article, however, focuses on England and the United States.

15. COURTNEY S. KENNY, THE TRUE PRINCIPLES OF LEGISLATION WITH REGARD TO PROPERTY GIVEN FOR CHARITABLE OR OTHER PUBLIC USES 5 (1880) (this work is also known as KENNY ON ENDOWED CHARITIES). Kenny found inspiration in the seminal article on the subject, *Fondation* by Turgot, which appeared in the Philosophes' *Encyclopédie*. (An English version is available in the appendix to the translation of MARQUIS CONDORCET, THE LIFE OF M. TURGOT (1787).) While Kenny agreed with much of Turgot's analysis, he would not go so far as to urge the suppression of all charities funded other than by general subscription. KENNY, *supra*, at 20–21. Turgot asserted: "May the following considerations

The occasional attack seems spurred by fears of the power that wealth is perceived to give the holder, such as churches or, more recently, private foundations. Today, however, the few legal limitations on charitable purposes, life, or activities have nearly evaporated.

This Article takes a fresh look at endowments and other charitable saving, which I estimate at over \$500 billion. Part I focuses the issue by defining the terms, identifying the scattered data, and describing the players, all in the context of law. We will see that the legal term "endowment" is narrower than its colloquial use; charities often self-designate funds for endowment which they may legally spend. We will also see that the timing issue is slipperier than initially appears: To some degree charities can effectively anticipate the endowment corpus by borrowing now and repaying in the future out of endowment income.

To place charity wealth in the broader political economy, Part II examines four defining legal developments in Anglo-American philanthropy. First, the story of endowment was, for hundreds of years, the story of land; accordingly, we review the laws of mortmain in England and the United States. Second, we revisit Henry VIII's dissolution of the monasteries, an event that still sends shivers down the spines of charity managers. Third, we examine fund raising by subscription, which began in the eighteenth century and continues in expanded form today. Finally, we sketch early American philanthropy, and discuss the twentieth-century changes in the law of private foundations.

Part III considers how legal reform could alter charity behavior. Managers, perhaps more than donors, determine the level of charity savings. Indeed, participants often act as if philanthropy performs a saving function that is as important as (if not more important than) spending. This passive wealth does not disappear, of course, and provides valuable investment capital to the proprietary sector. In the old days when single-donor charities dominated, such a use of charitable resources furthered the power of the dynastic family or of the social elite. More recently, many middle-class individuals have responded to endowment-building by the cultural and social groups with which they identify, exhibiting a democratization of dynasty.

This Article concludes that the hundreds of billions of dollars in endowments and other charity reserves serve a broader desire to save. If society likes this result, then the only necessary legal reform would be directed at rationalizing the use of assets; a major step forward would be liberalizing the *cy pres* doctrine, under which courts today only narrowly reform obsolete charitable trusts. If, however, society does not want charities to save on a broad scale, then reform that merely focuses on limiting donor restrictions would not alone appear to induce charity fiduciaries to increase current spending. Forcing charities to spend, though, could be wasteful. Instead, society could more sharply tailor the subsidies it provides to philanthropy through the tax system and directly. Moreover, we might better provide specific output subsidies to providers of public goods,

concur with the philosophic spirit of the age, in exciting an aversion to new foundations, and in destroying the remains of that superstitious respect which is entertained for the old!" CONDORCET, *supra*, at 382.

regardless of whether the provider is a charity.

I. THE WHO, WHAT, HOW MUCH, AND LAW OF ENDOWMENTS

A. *The Legal Structure Protects the Donor's Wishes*

No law requires a donor to impose a perpetuity on a charitable gift, or to restrict the charitable purpose, but donors commonly do both.¹⁶ The law requires trustees of a charitable trust to adhere to the donor's stated charitable purpose for the stated period, even if forever. No donor, of course, can see what society will be like many years hence. To temper the charitable trust exception to the rule against perpetuities, the "*cy pres*" doctrine permits the state to reform a charitable trust whose intended purposes can no longer be carried out.¹⁷ Courts usually apply this power as minimally as possible.¹⁸ By contrast, a gift to a charitable corporation does not invoke the rule against perpetuities, because ownership of property vests outright in a corporation. Frequently, though, courts apply a *cy pres* approach to

16. Automatic perpetuity is slyly undercut by the Internal Revenue Service's example of a charitable trust included in IRS Publication 557, "Tax-Exempt Status for Your Organization," at 15-16 (revised May 1997). Clause 3.B of this sample declaration of trust reads: "The trust shall continue forever unless the trustees terminate it and distribute all of the principal and income, which action may be taken by the trustees in their discretion at any time."

17. For a discussion of the rule against perpetuities, see *infra* note 125 and accompanying text. The ecclesiastical courts developed the *cy pres* doctrine when, prior to the development of the chancery courts, they supervised charitable trusts and bequests for pious purposes. See GEORGE W. KEETON, *THE MODERN LAW OF CHARITIES* 1 (1962).

18. G.G. BOGERT & G.T. BOGERT, *THE LAW OF TRUSTS AND TRUSTEES* § 431 (rev. 2d ed. 1991) (derived from *cy pres comme possible*, the French for "as near as possible"); Rob Atkinson, *Reforming Cy Pres Reform*, 44 *HASTINGS L.J.* 1111, 1118 (1993). The trust settlor may also grant discretion, and the limits on that discretion, to the trustees. See, for example, the letter of gift to the trustees of the John Solomon Guggenheim Memorial Foundation: "[N]o one can foresee the future, and limitations which seem wise today might become impracticable or injurious in later years. No man of wisdom would seek perpetually to bind you and your successors to fixed plans and methods involving fixed studies, causes, places or institutions." The letter continues, however:

Yet it seems to me appropriate that I should indicate to you those general purposes and policies, within the scope of the charter, to which I wish you and your successors to conform as long as is deemed best. If, at some distant time, it seems wisest in the careful judgment of the Trustees, to change or disregard them, you have here a statement of my wish that you do so; you will conform best to my wishes by using your own good judgment.

Letter from Simon Guggenheim to the Trustees of John Simon Guggenheim Memorial Foundation and Their Successors (Mar. 26, 1925), in *LEGAL INSTRUMENTS OF FOUNDATIONS* 269, 269-70 (F. Emerson Andrews ed., 1958).

corporate charities that need to depart from donor restrictions.¹⁹

In general, a charity need not expend its income in any particular period. In some situations, a charity begins with a small fund, the income of which its founder intends to accumulate until the principal grows to a certain amount. The law cooperates with such a plan by permitting the accumulation of income for long periods of dormancy if for a charitable purpose.²⁰ For example, courts upheld the accumulation provisions in Benjamin Franklin's bequest to trusts for the benefit of Boston and Philadelphia; however, the trustees resorted time and again to the courts to alter restrictions that kept the funds unproductive.²¹

Unfortunately, courts have provided but scant guidance on when a charity can legally invade an endowment corpus in order to spend for charitable purposes,²² or when creditors can reach endowment corpus.²³ One early English

19. See EVELYN BRODY, *THE LIMITS OF CHARITY FIDUCIARY LAW* 58-59 (Program on Non-Profit Organizations, Yale University, Working Paper No. 242, June 1997).

20. See EDITH L. FISCH ET AL., *CHARITIES AND CHARITABLE FOUNDATIONS* § 119 (1974) (a charitable trust may not accumulate all income in perpetuity). Whether or not states have legislated limits on accumulations, courts exercise equity powers to require that accumulations be reasonable in light of the charitable purpose and public policy. For example, the will in *In re Estate of James*, 199 A.2d 275 (Pa. 1964), established a trust for Masonic homes, with much of the income to be accumulated until termination and vesting in the Masons after 400 years. The court stated: "We are reluctant to ascribe to testator the paramount desire merely to turn an approximately \$50,000 trust fund into a final gift of almost \$15,000,000, at the expense of immediate social needs." *Id.* at 279. In making the income available to the beneficiary currently, the court observed: "Shifting and advanced social concepts, programs and concerns emphasize the hazards of seeking to correct or alleviate social problems so distantly removed from testator's generation." *Id.* at 280.

The corporate "accumulated earnings tax" does not apply to a tax-exempt corporation. See Henry Hansmann, *Why Do Universities Have Endowments?*, 19 J. LEGAL STUD. 3, 7 n.15 (1990). However, as described *infra* note 283 and accompanying text, "private foundations" must make a minimum annual distribution of at least 5% of net investment asset value (and the prior rule, old Internal Revenue Code § 504, revoked the tax exemption of a foundation that unreasonably accumulated its income). See Internal Revenue Code of 1954, ch. 736, 68A Stat. 3, 168, *repealed by* Tax Reform Act of 1969, Pub. L. No. 91-172, sec. 101, 83 Stat. 487, 527.

21. LEWIS M. SIMES, *PUBLIC POLICY AND THE DEAD HAND* 128, 141 (Appendix) (The Thomas M. Cooley Lectures, 6th ser. 1955).

22. Courts struggled for decades over whether corporate charities held their assets outright or in trust; after all, the trustee and the beneficiary cannot be the same person. New York grants corporate charities outright ownership, but requires adherence to use of the donation as directed by the donor, subject to enforcement by the attorney general. *St. Joseph's Hosp. v. Bennett*, 22 N.E.2d 305 (N.Y. 1939); see also FISCH ET AL., *supra* note 20, § 62 ("the law regarding whether endowment property is held in trust or absolutely is confused and vague"). Under the doctrine of "deviation," a charity may apply to a court for permission to, among other things, "encroach upon the corpus of a trust or endowment although entitled only to the income." *Id.* § 548 & n.32; see, e.g., VT. STAT. ANN. tit. 16, §§ 3681-3684 (1989) (authorizing education corporation or association to use such principal as the court determines necessary for rehabilitation or payment of indebtedness); Merchants

court allowed a charity to invade a short-term fund in an emergency: "A Stock of Money is given *in deposito*, to be expended in three years, about the repairing of a Bridge, if there be apparent likelihood, that the Bridge without employment of the whole, in a shorter time will fall down; they may decree, that the whole sum may be bestowed in a shorter time."²⁴ New York's high court prohibited a charity from using endowment—whose income was to be used "for the ordinary expenses of maintenance"—to make mortgage or any other nonmaintenance payments.²⁵

England maintains distinct supervisory schemes for charitable trusts and for charitable corporations. The attorney general, by recourse to the equity court, supervises the charitable trust. In contrast, the founder constitutes the "visitor" of the corporate charity, with rights to ensure proper management of the charity.²⁶ Specifically, English common law permits the founder of a charitable corporation "to reserve to himself or to a visitor whom he appoints the exclusive right to adjudicate upon the domestic laws which the founder has established for the regulation of his bounty."²⁷ The visitor's decision may not be appealed to the courts. "The value of the visitorial jurisdiction is that it is swift, cheap and final."²⁸

Donors in the United States lack the privilege of visitorship.²⁹ The donor's

Bank & Trust Co. v. Garrett, 33 So. 2d 603, 604 (Miss. 1948) (explaining donor would have preferred expenditure of principal to evicting the inmates of her retirement home "while the endowment would merely accumulate without being of service to anybody"). *But see* Franklin Found. v. City of Boston, 142 N.E.2d 367 (Mass. 1957) (prohibiting using the principal of the Carnegie donation to pay salaries or other current expenses, or to repay loans for these purposes).

23. FISCH ET AL., *supra* note 20, § 62 & n.4; *see, e.g.*, Hobbs v. Board of Educ. of N. Baptist Convention, 253 N.W. 627, 636 (Neb. 1934) (creditors cannot reach endowment held in trust unless the charity had already transferred endowment to general funds, even if this was improper). *See generally* J. Frederic Taylor, *A New Chapter in the New York Law of Charitable Corporations*, 25 CORNELL L.Q. 382, 383 (1940).

24. Sir Francis Moore, *Collections Out of the Learned Readings Upon the Statute of 43 Eliz.*, in GEORGE DUKE, *THE LAW OF CHARITABLE USES* 159 (1676).

25. *St. Joseph's Hosp.*, 22 N.E.2d at 305, 308.

26. In 1835, one English Charity Inquiry Commissioner complained:

[I]n most cases, [visitors] are a burden and inconvenience to the Charity, because the Visitors, being exempted from the jurisdiction of the Court of Chancery, are not subject to any control as to the internal management of the Charity in any respect; and it frequently happens that the advantage which might be derived from the visitorial power is wholly lost, because Charities subject to it are not at all looked into by the special visitors.

KENNY, *supra* note 15, at 147.

27. *Page v. Hull Univ. Visitor*, [1993] 1 All E.R. 97, 102 (House of Lords 1992) (opinion of Lord Browne-Wilkinson).

28. *Id.* at 100 (opinion of Lord Griffiths). Because the "visitor either is a person holding a high judicial office or is advised on questions of law by such a person, in whose decision on matters of law it is reasonable to repose a high degree of confidence," observed one member of the House of Lords, "as a practical matter the chances are that the visitor probably will get it right." *Id.* at 101 (opinion of Lord Griffiths).

29. *Wier v. Howard Hughes Med. Inst.*, 407 A.2d 1051 (Del. Ch. 1979).

legal rights cease upon a transfer to a charitable trust or corporation.³⁰ Granted, the charity can be held to terms imposed on a gift by the donor. But only the attorney general, rather than the donor herself, may bring suit. Nor, traditionally, may a donor suffering a change of heart later alter the conditions of a gift. As Austin Wakeman Scott noted, only the conditions imposed at the time of the gift are treated "like the law of the Medes and the Persians."³¹ This suggests that "at stake in modifying the terms of a trust is not only the wishes of an individual donor, but the wishes that the law has previously agreed to honor."³²

Modern state statutes have retreated from this transaction-based view of charitable acts. The Uniform Management of Institutional Funds Act (discussed shortly) provides a mechanism for releasing donor restrictions.³³ If the donor consents in writing, the charity's "governing board may release, in whole or in part, a restriction imposed by the applicable gift instrument on the use or investment of an institutional fund."³⁴ If, however, the donor's written consent cannot be obtained because of "death, disability, unavailability, or impossibility of identification," then the governing board may apply to court for release of the restriction.³⁵ By negative implication, the charity apparently may not apply for a judicial reformation over a living donor's objections.³⁶ Furthermore, the charity and the donor may not collude to injure the public interest; the charity must notify the attorney general, who is to be given an opportunity to be heard. The court may release any restriction, in whole or in part, that it finds to be "obsolete, inappropriate, or impracticable."

In sum, American law still grants enormous deference to donor-imposed conditions. Consider the most celebrated case in American philanthropy, the Buck Trust. In 1975 Beryl Buck bequeathed \$10 million worth of stock in an oil company to a trust for the benefit of Marin County, one of the richest counties in the country. Ten years later, when the stock had ballooned in value to \$400 million, the trustee possessing distribution powers sought court approval to spend some of the income to benefit the greater San Francisco Bay area. With the attorney general

30. See *Trustees of Dartmouth College v. Woodward*, 17 U.S. (4 Wheat.) 518, 614 (1819).

31. Francie Ostrower, *Donor Control and Perpetual Trusts: Does Anything Last Forever?*, in *PHILANTHROPIC GIVING: STUDIES IN VARIETIES AND GOALS* 279, 288 (Richard Magat ed., 1989) (quoting Austin W. Scott, *Education and the Dead Hand*, 34 *HARV. L. REV.* 1, 13 (1920)).

32. *Id.*

33. An "institution" is an incorporated or unincorporated organization formed and operated exclusively for "educational, religious, charitable, or other eleemosynary purposes." UNIF. MANAGEMENT OF INSTITUTIONAL FUNDS ACT § 1(1), 7A U.L.A. 705, 712 (1985 & Supp. 1997) (adopted in 40 states plus D.C.).

34. *Id.* § 7(a).

35. *Id.* § 7(b).

36. This raises the question of whether the objecting donor has standing to sue to enforce the restriction. See *Carl J. Herzog Found., Inc. v. University of Bridgeport*, 677 A.2d 1378 (Conn. App. 1996) (answering yes), *rev'd*, No. SC 15526, 1997 Conn. LEXIS 319 (Aug. 26, 1997).

opposing, the court denied relief; the trustee was replaced.³⁷

B. What Is an Endowment?

Not all assets held by charities constitute endowment. (Of course, the law can properly be concerned with charity holdings in forms other than endowment; moreover, to the extent wealth bestows political power, society might not always distinguish between operating and investment wealth.) John Stuart Mill defined a "foundation or endowment" as "money, or money's worth (most commonly land) assigned, in perpetuity or for some long period, for a public purpose."³⁸ The common use of the word is much broader than its legal definition. The best way to understand the legal concept of endowment is to appreciate what it is *not*.

1. Not a Mere Surplus; Not All Investment "Principal"

As a legal matter an endowment must be distinguished from a surplus or "rainy-day fund." Reserves, unlike endowment, represent a cushion that can be drawn down at the discretion of the charity.³⁹

Under traditional fiduciary trust law, the charity could not spend the portion of an endowment labeled "principal" but rather could spend only "income."⁴⁰ Managers believed that asset appreciation (realized and unrealized) belonged to unreachable principal.⁴¹ Accordingly, some managers attempted to

37. See HARVEY P. DALE, *THE BUCK TRUST* (1987); John G. Simon, *American Philanthropy and the Buck Trust*, 21 U.S.F. L. REV. 641 (1987). Another trustee opposed using any Trust funds for the petitioner trustee's attorneys fees, and sought to surcharge the petitioner for them; there can be no doubt that the petitioner's resignation was conditioned on eliminating this possibility. See Ronald H. Hayes et al., *The Buck Trust Trial—A Litigator's Perspective*, 21 U.S.F. L. REV. 585, 634 (1987).

38. John Stuart Mill, *Corporation and Church Property*, THE JURIST, Feb. 1833, at 1, 3, quoted in slightly altered form in the Preface to LEGAL INSTRUMENTS OF FOUNDATIONS, *supra* note 18, at 11.

39. See Hansmann, *supra* note 20, at 24 ("Yale did not withdraw substantial funds from its endowment to help it through the financial crisis of the 1970s. During that decade Yale, like most universities, found itself suddenly in straitened circumstances: private demand declined, government support abruptly stopped its former upward trajectory, and energy costs increased dramatically.").

40. Separating endowment from mere surplus gets harder the older the charity. The early records of Harvard "lacked any differentiation between capital and (endowment) income." MARGERY SOMERS FOSTER, "OUT OF SMALLE BEGININGS...": AN ECONOMIC HISTORY OF HARVARD COLLEGE IN THE PURITAN PERIOD 23 (1962). Foster adds:

Actually the distinction between capital and income was not always clear in British accounting until the permanent capital principle was used in the "non-terminable" stock companies of the sixteenth, and, more commonly, the seventeenth, centuries.... It was not until Victorian times that English laws actually prohibited commercial companies from reducing permanent capital to pay dividends.

Id.

41. See generally BEVIS LONGSTRETH, *MODERN INVESTMENT MANAGEMENT AND THE PRUDENT MAN RULE* (1986).

defeat income-only restrictions by investing in high-income yielding bonds rather than stock. Such practices eroded the real value of endowment while remaining within the confines of fiduciary duties.⁴² A 1969 Ford Foundation study found that no court decision on the income-versus-appreciation question involved a charitable endowment fund, and accordingly urged managers to focus on "total return" rather than on "income."⁴³ The reform movement culminated in the 1974 Uniform Management of Institutional Funds Act, adopted in most states. UMIFA endorses the academics' total-return concept.⁴⁴ The higher education subsector has embraced various spending formulae based on total return on endowment value.⁴⁵

42. See J. PETER WILLIAMSON, *FUNDS FOR THE FUTURE: COLLEGE ENDOWMENT MANAGEMENT FOR THE 1990'S* 5-104 (Common Fund 1993) ("[T]he real resistance was to...changing the traditional spending policies."). Those "that prided themselves on spending only income yield, and invested all of their endowment assets in high-yielding fixed-income securities, gave up all chance of appreciation, even appreciation to cope with inflation, but operated entirely within the limits of traditional spending practices." *Id.* at 5-104 to 5-105.

43. WILLIAM L. CARY & CRAIG B. BRIGHT, *THE LAW AND THE LORE OF ENDOWMENT FUNDS* 6 (1969) ("It should be stressed at the outset that the purpose of this report is not to advocate either the expenditure or the preservation of capital gains" but rather "merely to determine whether the directors of an educational institution are circumscribed by the law or are free to adopt the investment policy they regard as soundest for their institution, unhampered by legal impediments, prohibitions or restrictions."). Meanwhile, the U.S. Treasury Department issued regulations describing which investments made by a private foundation would jeopardize carrying out its exempt purposes. The regulations adopted a total return approach, as well as a policy of examining investment decisions in the context of the entire portfolio. Treas. Reg. § 53.4944-1(a)(2) (1972).

44. See UNIF. MANAGEMENT OF INSTITUTIONAL FUNDS ACT § 6, 7A U.L.A. 705, 721 (1985) (stating that prudence includes considering, among other factors, "expected total return on...investments"). Unfortunately, federal income tax rules that apply to private foundations encourage the opposite investment strategy. The 2% foundation excise tax applies only to the foundation's "income," defined to exclude unrealized capital gains. I.R.C. § 4940(c) (1994). Accordingly, a foundation minimizes this tax if it invests in growth stocks and holds those stocks. Cf. THE COMMISSION ON FOUNDATIONS AND PRIVATE PHILANTHROPY, *FOUNDATIONS, PRIVATE GIVING, AND PUBLIC POLICY* 148-49 (1970) [hereinafter PETERSON COMMISSION REPORT] (raising the same concern in the context of the minimum distribution requirement, which at the time required a foundation to distribute each year whichever was greater, 6% of its net investment assets or its "income"; the definition of "income" for this purpose excluded realized and unrealized capital gains).

45. A 1996 survey by the National Association of College and University Business Officers ("NACUBO") found that 299 (64%) of the 467 reporting institutions "[s]pend a prespecified percentage of a moving average of market values" and additional schools apply various non-income-based formulas. 1996 NACUBO ENDOWMENT STUDY, EXECUTIVE SUMMARY 6 (Cambridge Associates 1997) [hereinafter NACUBO, EXECUTIVE SUMMARY].

NACUBO questions "how many institutions with a policy of spending $x\%$ of a y -year average of endowment market values recognize that a significant ebbing of the bull-market tide could result not only in a diminution in the growth in spending they have enjoyed in the past decade, but quite possibly in an actual decline in spending dollars." 1996 NACUBO ENDOWMENT STUDY 6 (Cambridge Associates 1997); cf. Hansmann, *supra*

UMIFA also contains an "out" that theoretically could permit trustees to eviscerate an endowment, given enough inflationary and real growth. The statute permits trustees to spend a "prudent" portion of endowment appreciation (realized and unrealized) over its historic dollar value when contributed.⁴⁶ However, state modifications to UMIFA might apply. For example, Massachusetts creates a rebuttable presumption of imprudence from "the appropriation of net appreciation for expenditure in any year in an amount greater than seven percent of the fair market value of the institution's endowment funds."⁴⁷

2. Not Program Assets

An endowment must be distinguished from the charity's physical plant and other assets used in carrying out its charitable functions, such as university campuses, hospital facilities, and museums. That is, the *wealth* of a particular charity includes both its operating and its passive investment assets.⁴⁸ Sometimes, however, operating assets raise the same questions as endowments. For example, given the vast collections placed in storage by major art museums, should they ever

note 20, at 21–26 (1990) ("[T]he spending rules currently popular among universities, which call for spending a given fraction of the real value of the endowment annually, are directly inconsistent with a policy of using the endowment as a financial buffer. Such a rule commits an institution to using its operating budget as a buffer to absorb shocks to the market value of its endowment, rather than vice versa."). While spending formulas might have to be altered, endowment erosion should not be a concern: Despite the surge in endowment performance, the 1996 NACUBO survey found that, in total, institutions "spent" only 4.3% (while expending an additional 0.5% on investment management, and "withdrawing" an additional 0.8%). 1996 NACUBO ENDOWMENT STUDY, *supra*, at 56 exhibit 8A.

46. UNIF. MANAGEMENT OF INSTITUTIONAL FUNDS ACT §§ 1(5), 2, 7A U.L.A. at 712–13, 716. As John Simon phrased it to me, this is really a form of permitted invasion.

47. See FISCH ET AL., CHARITIES AND CHARITABLE FOUNDATIONS, 1990–91 CUMULATIVE SUPPLEMENT § 439 & n.7 (1990) (quoting MASS. GEN. LAWS ANN. ch. 180A, § 2 (West 1975)).

48. Charities sometimes face program conflicts managing their endowments. The *Third Restatement of Trusts* approves a charity's considering whether its charitable purposes would justify spending funds "for the social issue or cause in question," or whether the investment decision advances, "financially or operationally," a charitable activity of the trust. RESTATEMENT (THIRD) OF TRUSTS: PRUDENT INVESTOR RULE § 227 cmt. c, at 13 (1990) (stating general requirements of loyalty and impartiality); *id.* Reporter's Notes, cmt. c, at 68–70 (discussing social investing). For example, "program-related investments" are made more to advance a charitable purpose than to earn a financial return. I.R.C. § 4944(c) (1994). See generally LOREN RENZ ET AL., PROGRAM-RELATED INVESTMENTS: A GUIDE TO FUNDERS AND TRENDS (Foundation Center 1995). At the other extreme, a charity might divest or shun holdings in corporations whose activities clash with its charitable purpose, or otherwise represent tainted money. In the 1980s, institutions divested stock in companies doing business in South Africa; recently, institutions have been investing in mutual funds that exclude stocks of tobacco companies. See, e.g., Glenn Collins, *S.E.C. Allows Priests' Bid for Vote on Nabisco Spinoff*, N.Y. TIMES, Jan. 3, 1996, at D3.

"deaccession" some of their holdings?⁴⁹

The nonprofit sector's "edifice complex" is well-known. However, raising money for repair is less glamorous.⁵⁰ Even well-endowed colleges and universities suffer from decaying campuses.⁵¹ As of 1989, of the estimated \$60 billion backlog in campus infrastructure spending, \$20.5 billion was categorized as urgent.⁵² A co-author of that study complained: "If endowments had eroded over the last thirty years at a rate commensurate with the erosion of facility assets, it would be deemed catastrophic."⁵³ A study of the nonprofit service sector found an \$87 billion shortfall in nonendowment capital needs.⁵⁴

3. Not Self-Imposed

Only a donor can impose a legally binding income-only restriction, and a significant percentage seemed inclined to do so. For example, of gifts to higher education, donors recently gave 43% for capital purposes, but only 13% for buildings and equipment; 27% of total giving was directed to "endowment: income restricted" (3% for "endowment: income unrestricted").⁵⁵

A charity's self-imposed restriction to maintain principal cannot be legally enforced; the charity can always change its mind.⁵⁶ Either by design or default, most charities manage their resources so as to retain and even grow their surplus, with no intention of ever spending it down.⁵⁷ Sometimes charities voluntarily

49. See, e.g., Jennifer L. White, Note, *When It's OK to Sell the Monet: A Trustee-Fiduciary-Duty Framework for Analyzing the Deaccessioning of Art to Meet Museum Operating Expenses*, 94 MICH. L. REV. 1041, 1045-46 n.21 (1996) (quoting museum industry codes of ethics that limit the use of sale proceeds to the acquisition or preservation of collections).

50. A donor might contribute funds sufficient to build a school (capital contribution), with enough left over (endowment) to generate income for maintenance.

51. For example, Yale University reportedly faces a \$1.1 billion cost of "refurbish[ing] its leaking dorms and dilapidated classrooms." Shawn Tully, *Finally, Colleges Start to Cut Their Crazy Costs*, FORTUNE, May 1, 1995, at 110, 112.

52. NACUBO EXECUTIVE BRIEFING PAPER: CAPITAL RENEWAL AND REPLACEMENT 5, 7 (1991) (citing SEAN C. RUSH & SANDRA L. JOHNSON, *THE DECAYING AMERICAN CAMPUS* (1989)) [hereinafter NACUBO, CAPITAL RENEWAL].

53. Sean C. Rush, *Facilities as a Capital Asset*, in FACILITIES STEWARDSHIP IN THE 1990S 1, 4 (Nov. 1990). Cf. NACUBO, CAPITAL RENEWAL, *supra* note 52, at 11 ("Unlike most financial endowments, facilities are providing less value to many institutions than they did 15 or 20 years ago.").

54. GIVING USA: THE ANNUAL REPORT ON PHILANTHROPY FOR THE YEAR 1994, at 34 & n.13 (1995) (citing to Basil J. Whiting, *The Facilities Gap* (Health and Human Services Facilities Project, Aug. 1994)).

55. COUNCIL FOR AID TO EDUC., VOLUNTARY SUPPORT OF EDUCATION 1995 VS95/8 tbl.7 (1996) (percentages rounded to nearest integer).

56. If a charity solicits contributions with the promise to spend only income, the restriction could be viewed as donor imposed. See, e.g., *Crane v. Morristown Sch. Found.*, 187 A. 632 (N.J. Eq. 1936) (presumption).

57. Howard P. Tuckman & Cyril F. Chang, *Nonprofit Equity: A Behavioral Model and Its Policy Implications*, 11 J. POL'Y ANALYSIS & MGMT. 76, 77-78 (1992)

classify free assets as endowment in order to look more needy to potential donors. In 1993, the Financial Accounting Standards Board (FASB), over fierce opposition from charities, required charities to more clearly categorize their assets as unrestricted or restricted.⁵⁸ Under FASB's terminology, charity funds are either "endowment" (in the legal sense, as donor imposed), "quasi-endowment" (self-imposed but legally expendable), or current fund (freely spendable).⁵⁹ One study of aggregate university endowments found that 61.4% was allocated to true perpetual endowment, 1.4% to term endowment, and 33.6% to quasi-endowment.⁶⁰ The accumulated gains over the historic book value of donor-restricted endowment are generally treated as unrestricted. Overall, this group classified 56% of their true endowment as permanently restricted, 29% as unrestricted, and 15% as temporarily restricted.⁶¹

("[T]he vast majority of charitable nonprofit organizations accumulate equity and...the real value of their equity grows over time." (citations omitted)).

58. See FINANCIAL ACCOUNTING STANDARDS BD., STATEMENT OF FINANCIAL ACCOUNTING STANDARDS NO. 117: FINANCIAL STATEMENTS OF NOT-FOR-PROFIT ORGANIZATIONS 5-6 (June 1993) [hereinafter S.F.A.S. NO. 117]; see, e.g., Nancy M. Kane, *Report on the Financial Resources of Major Hospitals in Boston* (Boston Comm'n of Health & Hospitals, May 10, 1993) ("[A]ccounting practices have complicated the identification of board-designated, or 'discretionary' cash resources of hospitals. For example, two hospitals (Brigham, St. Elizabeth's) combine board designated assets with donor-restricted and trustee-held assets under the 'current assets whose use is limited' designation."); see also Henry C. Suhrke, *Endowment Accountability*, PHILANTHROPY MONTHLY, Oct. 1991, at 5.

59. As a separate matter, funds can be "restricted" or "unrestricted." In S.F.A.S. NO. 117, *supra* note 58, at 77, the FASB defines an "endowment fund" as:

An established fund of cash, securities, or other assets to provide income for the maintenance of a not-for-profit organization. The use of the assets of the fund may be permanently restricted, temporarily restricted, or unrestricted. Endowment funds generally are established by donor-restricted gifts and bequests to provide a permanent endowment, which is to provide a permanent source of income, or a term endowment, which is to provide income for a specified period. The principal of a permanent endowment must be maintained permanently—not used up, expended, or otherwise exhausted—and is classified as permanently restricted net assets. The principal of a term endowment must be maintained for a specified term and is classified as temporarily restricted net assets. An organization's governing board may earmark a portion of its unrestricted net assets as a board-designated endowment (sometimes called funds functioning as endowment or quasi-endowment funds) to be invested to provide income for a long but unspecified period. The principal of a board-designated endowment, which results from an internal designation, is not donor restricted and is classified as unrestricted net assets.

60. 1996 NACUBO ENDOWMENT STUDY, *supra* note 45, at 51 Exhibit 6A (3.7% of funds are held in trust by others).

61. *Id.* at 4.

4. How Big Are American Charitable Endowments?

No aggregate data on pure endowments exist.⁶² It is easier to estimate investment net wealth. The most complete statistics come from the Internal Revenue Service, which compiles data from the information returns that charities file: Because of the distinct regulatory schemes that apply to "public charities" and "private foundations,"⁶³ the IRS provides separate reports on the annual "Forms 990" and "Forms 990-PF." Tax return data, however, suffer from two shortcomings. First, Congress exempts churches from filing.⁶⁴ Second, the IRS publishes the data as reported, and filers commonly make mistakes on these forms.

Not all charities have significant savings, and most charity investment assets are held by a minority of charitable organizations.⁶⁵ In the aggregate, tax data from 1993 show that public charities held about \$421.5 billion in investment (nonoperating) assets, consisting of \$320.7 billion in securities, \$18.3 billion in investment real estate, and \$82.5 billion in other passive investments (small charities filing the "EZ" information return reported an additional \$1 billion in undifferentiated "cash, savings, and investments").⁶⁶ This \$490.5 billion figure is,

62. Endowments in higher education appear in the annual survey conducted by the NACUBO. Of 472 institutions participating in NACUBO's 1996 survey, 467 reported endowment assets totaling \$123.2 billion. *Id.* at 3. The philanthropy world is eagerly watching the development of a data base of the 200,000 most active operating charities, by a new (nonprofit) organization called Philanthropic Research, Inc. ("PRI") in Williamsburg, Virginia. In the summer of 1996, PRI beta-tested a CD-ROM containing survey information on 42,000 organizations. Of these, 6000 had endowments ranging from miniscule to sufficient to permit current operations to continue for 50 years without additional income. This data set excluded universities and hospitals. I eyeballed the listing for the 820 organizations with endowment sufficient to finance two years or more of spending, and grouped them based on their name: 26% were museums, libraries, zoos, gardens, and symphonies and other cultural institutions; 20% were community foundations; 23% supported hospitals, medical research, and children's or adult homes; 7% were Boy Scouts, YMCA, 4-H, or fraternal charities; 7% supported academic research or schools; a handful were retirement homes for various congregations, or Jewish charities; and the remaining 13% were humane societies, general social service providers, or unclassifiable on the basis of name. PRI is in the process of updating its financial information to FY96 data for every 501(c)(3) public charity, including hospitals and educational institutions, that files with the IRS. Although this information will not be available as a complete data set until the fall of 1998, individual charity data will be updated as it becomes available, and may be viewed at the PRI website at www.guidestar.org. E-mail communication from Chuck McLean, Dir. of Research at PRI, to Evelyn Brody (July 10, 1997) (on file with the author).

63. See *infra* note 278 and accompanying text.

64. Congress and the Internal Revenue Service also exempt charities with annual gross receipts of less than \$25,000. I.R.C. § 6033(a)(2)(B) (1994); Rev. Proc. 83-23, 1983-1 C.B. 687. These organizations are unlikely to have significant savings.

65. For example, in 1986, just 3% of colleges and universities owned 72% of total higher education endowment funds. NACUBO, ENDOWMENT MANAGEMENT, *supra* note 9, at 5.

66. Cecelia Hilgert, *Charities and Other Tax-Exempt Organizations, 1993*, SOI BULL., Spring 1997, at 122, 126 tbl.1, 133 tbl.4. The IRS requires securities to be listed at

however, extremely misleading because it includes about \$126.5 billion in assets held by T.I.A.A./C.R.E.F., the teachers' retirement fund, which, until recent legislation, enjoyed charity tax status.⁶⁷ Accordingly, for public charity tax-filers' investments in 1993, I will use a value of \$296 billion. In addition, private foundations—the nonpublic charities that primarily make grants to other charities—held about \$195 billion in investment assets in 1993.⁶⁸ Regrettably, no complete data on church holdings exist. A survey of religious congregations reports that the sector received \$1.3 billion in “investment or endowment income” in 1992.⁶⁹ Assuming just a 5% realized rate of return, this capitalizes to a value of \$26 billion.⁷⁰ As a very rough estimate of the charitable investment base (rather than just perpetuities imposed by donors on contributions), we could sum these figures for a total of \$517 billion; because of the spectacular recent growth in the stock market, the current total is surely higher.⁷¹

fair market value. Filers separately report their operating assets (cash and temporary investments, real estate and equipment, and other exempt-function assets). See *infra* note 86 and accompanying text. A study of 1990 returns shows that investments represented 20% of total assets of operating charities, and 53% of support organizations' assets. VIRGINIA A. HODGKINSON ET AL., A PORTRAIT OF THE INDEPENDENT SECTOR: THE ACTIVITIES AND FINANCES OF CHARITABLE ORGANIZATIONS 63 (1993).

67. This 1993 figure is the sum of \$67,483 million for the Teacher's Insurance Annuity Association and \$59,127 million for the College Retirement Equity Fund. I thank Cecelia Hilgert for providing me with these figures in a telephone conversation on August 20, 1997. For a description of T.I.A.A./C.R.E.F.'s tax status, see *infra* note 383 and accompanying text.

68. Paul Arnsberger, *Private Foundations and Charitable Trusts, 1993*, SOI BULL., Winter 1996-97, at 118, 125 tbl.1. See generally Alicia Meckstroth & Paul Arnsberger, *Private Foundations and Charitable Trusts: A Decade of Charitable Giving and Growth, with Highlights of 1991 and 1992*, SOI BULL., Summer 1996, at 65.

69. VIRGINIA A. HODGKINSON, FROM BELIEF TO COMMITMENT: THE COMMUNITY SERVICE ACTIVITIES AND FINANCES OF RELIGIOUS CONGREGATIONS IN THE UNITED STATES 73 tbl.4.23 (1993 ed.). These researchers sent surveys to 1000 religious congregations; with a 62% response rate, the researchers then weighted the information nationally to 258,000 religious congregations. The survey requested the same financial information as required by the IRS Form 990—but omitted questions about assets.

70. *But cf.* MARTIN A. LARSON & C. STANLEY LOWELL, PRAISE THE LORD FOR TAX EXEMPTION 244 (1969) (estimating that the total value of Protestant and Catholic churches' stocks, bonds, and investment real estate came to \$22 billion (producing income of \$1.1 billion), and that their commercial business property was worth \$16 billion (producing income of \$1.6 billion)). *Time* magazine, with the cooperation of the Church of Jesus Christ of the Latter-Day Saints, recently estimated the investment wealth of the Mormon Church at \$6 billion, plus another \$5 billion in ranch and farm real estate. David Van Biema, *Kingdom Come; Salt Lake City Was Just for Starters—the Mormons' True Great Trek Has Been to Social Acceptance and a \$30 Billion Church Empire*, TIME, Aug. 4, 1997, at 50, 54.

71. For example, the higher education endowments grew 16.9% in the fiscal year ending June 30, 1995, and a further 20.6% in the fiscal year ending June 30, 1996. NACUBO ENDOWMENT STUDY, *supra* note 45, at 8 (dollar-weighted mean returns; the largest determinant of high performance was the percentage of endowment assets allocated to equities as compared with other assets, particularly bonds).

C. Can—and Do—Charities Use Borrowing to Anticipate Endowment?

An income-only spending policy affects *only* the timing of charitable activity. Economically, the present value of the future income to be earned on a lump sum equals the current amount of that principal (the actual return earned depends on factors such as asset allocation and willingness to undertake risk). Thus, saving does not help a charity achieve greater spending, *ex ante* and other things being equal.⁷² An unrestricted charity can, in theory, expend all of its funds immediately, and benefit many current beneficiaries. By contrast, a perpetual charity benefits a small number of people in each succeeding generation.

How does access to credit change this calculation? Assume that Charity X possesses only a \$1 million endowment. Invested wholly in riskless Treasury bonds, Charity X's endowment can earn, let us say, 5%, or \$50,000 a year. Such a reliable income stream can support repayment of a loan in the principal amount of somewhat less than \$1 million. *Voilà!* Charity X has just converted its endowment to a currently expendable fund, albeit at a price.

Concerned that charities might unfairly grow simply by borrowing to produce investment income, Congress subjects charities to ordinary income tax on debt-financed passive income.⁷³ However, because Congress favors borrowing for charitable purposes,⁷⁴ it looks the other way for all but the most blatant tax arbitrage. Under a generous tracing rule, a charity can continue to earn endowment income tax-free so long as it uses the debt proceeds to directly conduct a charitable activity.

Moreover, sophisticated endowment managers use securities lending, short selling, and notional principal contracts (such as interest-rate swaps measured on a notional base amount) to enhance returns. Congressional enactments and Treasury Department guidance exclude these types of transactions from the debt-financed rules.⁷⁵ According to *Forbes* magazine, the director of Harvard

72. But see the discussion, *infra* notes 73–83 and accompanying text, of charity borrowing: A large endowment helps a charity win a higher bond rating, and hence a lower interest rate. See, e.g., Standard & Poor's, *Current Trends in Higher Education*, STANDARD & POOR'S CREDIT WK. MUN., Special Edition 1995, at 11–15 (providing, among other data, the debt/total-endowment percentages for years 1990–1994; in general, the bond rating falls as the ratio grows).

73. I.R.C. § 514 (1994), and the Treasury Department regulations thereunder, treat debt-financed investment income as "unrelated business taxable income." An exception is provided for leveraged investments in real estate by colleges and universities. I.R.C. § 514(c)(9).

74. However, charities often find it difficult to borrow: "[B]anks are reluctant to lend to nonprofits because of the difficulties involved in laying claim to specialized assets when a venture fails and the adverse publicity that surrounds the reclaiming of these assets." Howard P. Tuckman & Cyril F. Chang, *Accumulating Financial Surpluses in Nonprofit Organizations*, in GOVERNING, LEADING, AND MANAGING NONPROFIT ORGANIZATIONS 253, 262 (Dennis R. Young et al. eds., 1993).

75. For a recent summary discussion, see Robert H. Swart, *Using (or Abusing) an Exempt Organization's Tax Exemption*, TAXES, Dec. 1996, at 1034, 1037–38. As to

Management Co. "decided to use Harvard's in-house trading talent and its impeccable credit rating to leverage the return with derivatives."⁷⁶ In 1995, Harvard went "long \$21.5 billion in stocks and bonds and short \$13.8 billion," at a time when its actual endowment assets were worth \$7.7 billion.⁷⁷ Rather than making one-way bets, Harvard uses such techniques to hedge, squeezing out small arbitrage profits on a large scale.⁷⁸ "Leverage and locking in of market anomalies...has been worth 370 basis points annually to [Harvard's domestic bond] portfolio," and its domestic stocks gained 30% more than the Standard and Poor's 500 index.⁷⁹

short sales, see Rev. Rul. 95-8, 1995-1 C.B. 107; as to notional principal contracts, see Treas. Reg. § 1.512(b)-1(a) (as amended in 1992). In a 1978 amendment to Internal Revenue Code § 512(a)(5), (b)(1), Congress excluded the returns from securities loans from tax.

76. Robert Lenzner & Stephen S. Johnson, *Harvard Is Knee-Deep in Derivatives*, FORBES, Nov. 20, 1995, at 106, 112 (cover story). Lenzner and Johnson continue:

Here's an example: Harvard bought a blend of 10.75% Treasuries and zero coupon Treasuries. The package had a duration and return comparable to that of an eight-year Treasury bond. However, the package cost slightly less than the eight-year Treasury was selling for at the time. To capture this small discrepancy, Harvard sold short the real eight-year Treasury bond while staying long the blended bond equivalent. Hopefully, the valuations of the bonds converge and you can unwind the positions at a profit.

Obviously, you can't make a lot of money off a tiny spread in the bond market unless you go in on a huge scale. Harvard took a \$5 billion position on the bond hedge explained above. Where did it get \$5 billion, when its total capital was only \$7.7 billion? Borrowed it, of course. Its triple A credit rating let the university leverage itself cheaply through interest rate swaps and security loans. This leverage enables Harvard to magnify the gains on the tiny spread. It hoped to make a cool \$100 million from the \$5 billion Treasury position.

Id. at 106-07; see also Bary, *supra* note 4, at 36 (describing Harvard's 1995 interest-rate swap on Italian government bonds, which produced a \$50 million profit). The *Forbes* article describes how Harvard protects itself against the risk of a bond market crash, which could lead to margin calls when credit dries up: "To guard against a 'doomsday scenario,' the university pays millions in standby fees to banks worldwide. These fees make sure credit will be available in a crisis." Lenzner & Johnson, *supra*, at 107. Among other "pesky problems" Harvard faces, *Forbes* notes: "When The Street finds out that Harvard is borrowing a large securities position, it sometimes buys the securities and pressures Harvard to deliver them." *Id.* at 108. In addition, over-the-counter transactions, unlike exchange-traded contracts, involve counterparty risk; "at times the university has to threaten legal action when collateral contracts are not honored properly." *Id.*

77. Lenzner & Johnson, *supra* note 76, at 106.

78. Bary, *supra* note 4, at 34.

79. Lenzner & Johnson, *supra* note 76, at 112 (comparing the 12.9% rate of return Harvard earned on its domestic bond portfolio between 1991 and 1995 to the 9.2% return earned by the benchmark Salomon Broad Investment Grade Index; in the same period, Harvard's common stocks gained an average of 17% at a time when the S&P 500 stock index gained 13.1%). Defending the \$6.1 million in compensation paid to Jonathon

Finally, if the charity's reason for borrowing is for its exempt purpose rather than to produce investment income, then Congress permits the charity to issue subsidized tax-exempt bonds; in 1993, over \$70 billion in so-called (c)(3) bonds were outstanding.⁸⁰ Generally, charities borrow only to acquire "bricks and mortar" assets, although they can bond for working capital. Because repayment rarely is secured by a mortgage, revenue streams must be predictable enough to support an acceptable bond rating.⁸¹ Needless to say, the opportunity to issue cheap debt attracts many well-endowed charities. As a result, in 1986, Congress imposed a \$150 million aggregate limit per charity except for hospitals; the universities, in particular, fought for years to get this ceiling raised or even eliminated and finally succeeded in 1997.⁸² The tax-exempt bond "antiarbitrage" rules require issuers to

Jacobson, the in-house manager of the stock portfolio, Harvard Management's president observed that Jacobson produced \$300 million in additional value over benchmark targets: "In a real sense, Jon is perhaps the biggest benefactor Harvard has ever had." Bary, *supra* note 4, at 31.

80. I.R.C. §§ 103, 145 (1994); Hilgert, *supra* note 66, at 126 tbl.1.

81. See, e.g., Mary Peloquin-Dodd & Lisa Danzig, *California Statewide Community Development Authority: J. Paul Getty Trust*, STANDARD & POOR'S CREDIT WK. MUN., Oct. 30, 1995, at 102 (Aside from the museum's enormous level of unrestricted assets, "management expects that revenues from parking fees, bookstore sales, and food service revenues will alone be sufficient to support debt service on the bonds."). See generally Myron P. Curzan, *Real Estate Management: A Growing Institutional Responsibility*, in FACILITIES STEWARDSHIP IN THE 1990s, *supra* note 53, at 64, 75-77 (explaining that in the higher education subsector, "self-supporting" facilities include student housing, dining facilities, parking, recreational facilities, student unions, and bookstores; research facilities are "revenue-neutral"; and facilities such as academic, administrative, and conference facilities are "non-sustaining"). In general, "commercial nonprofits" (which earn most of their revenues):

are more likely to borrow than donative nonprofits. These organizations are business-oriented, and their finances tend to be organized in a manner that lenders understand. They are also in a position where, if a for-profit competitor borrows, they may find it necessary to borrow as well to maintain their competitive position.

Howard P. Tuckman, *How and Why Nonprofit Organizations Obtain Capital*, in NONPROFIT ORGANIZATIONS IN A MARKET ECONOMY 203, 228-29 (David C. Hammack & Dennis R. Young eds., 1993).

Charities dependent on gifts are the least likely to win an investment-grade bond rating. Mary Peloquin-Dodd, *Tax-Exempt Foundation: A Growing Interest in Debt*, STANDARD & POOR'S CREDIT WK. MUN., Oct. 30, 1995, at 99. By contrast, private foundations are starting to issue tax-exempt bonds, most often to finance headquarters or administrative offices. *Id.* at 100. In rating these bonds:

a high proportion of unrestricted or designated net assets is preferred because it gives the foundation greater flexibility.... However, a sizeable portfolio even if restricted produces spendable income.... Most foundations are not encumbered by donor restrictions; their assets can be considered to be unrestricted or available for any foundation purpose.

Id.

82. The Tax Reform Act of 1986 enacted I.R.C. § 145 ("Qualified 501(c)(3) Bonds"), including the \$150 million cap in paragraph (b). Pub. L. No. 99-514, § 1301, 100 Stat. 2085, 2629-30 (1986) (note that this restriction applies only to private charities, and

rebate to the government the difference between the amount of any investment income they earn on the proceeds and the interest rate they pay. Again applying a tracing approach, however, these rules do not consider a charity possessing an endowment as "debt financing" its investments, so long as the bond proceeds are not *secured* by the endowment.⁸³

While detailed data on charity borrowing are not available, tax returns for 1993 show a total of \$438 billion in liabilities.⁸⁴ "Liability," though, is a broad concept in the charity world: In 1993, charities reported, in addition to the \$70 billion in tax-exempt bonds described above, approximately \$107.5 billion in "mortgages and other notes payable"; \$92 billion in "accounts payable," "grants payable," and amounts "designated for future periods"; and \$168 billion in "other

not, by contrast, to public colleges and universities). As of 1990, about two dozen colleges had "capped out." John W. Gibb, *Funding Sources*, in FACILITIES STEWARDSHIP IN THE 1990S, *supra* note 53, at 47, 53. Indeed, private schools accelerated their tax-exempt borrowing in anticipation of the legislation: 1985 volume spiked at \$10.08 billion, compared with \$3.458 billion in 1984, \$6.99 billion in 1986, and \$4.208 billion in 1987 (subsequently climbing in later years). David M. Cyganowski, *Financing Options*, in FACILITIES STEWARDSHIP IN THE 1990S, *supra* note 53, at 33, 34 fig.1. More recently, see, for example, Karen Pierog, *Illinois Education Authority Unites Hospital, Zoo, Universities in Issue*, BOND BUYER, Nov. 27, 1995, at 1 (stating that Northwestern University, Loyola University of Chicago, and the University of Chicago have all "exhausted their ability to issue new tax-exempt debt").

In the summer 1997 budget negotiations, the Senate proposed eliminating the cap on nonhospital 501(c)(3) bonds issued to finance capital expenditures. The Senate Finance Committee report declared:

The Committee believes a distinguishing feature of American society is the singular degree to which the United States maintains a private, non-profit sector of private higher education and other charitable institutions in the public service.... The Committee finds particularly inappropriate the restrictions of present law which place these section 501(c)(3) organizations at a financial disadvantage relative to substantially identical governmental institutions.

Comm. on Finance, Rep. on S. 949, Revenue Reconciliation Act of 1997, 105th Cong. 1st Sess. 24-25 (June 20, 1997). The House, by contrast, proposed to lift the ceiling gradually to \$200 million. Revenue Reconciliation Bill of 1997, H. Ways & Means Comm. Rep., Bill Text and Explanation 47-48 (as released June 18, 1997). Congress adopted the Senate proposal, effective for bonds issued after the date of enactment, specifically for "bonds issued with respect to capital expenditures incurred after the date of enactment." H.R. Rep. No. 105-220, at 51-52 (1997). The President signed the Taxpayer Relief Act of 1997 into law on August 5, 1997, Pub. L. No. 105-34 (1997).

83. I.R.C. §§ 103(b)(2), 148 (1994). If the borrowing is secured by an investment fund, the charity would either have to restrict the yield to match the tax-exempt rate at which it is bonding, or rebate the difference to the federal government. As a separate matter, while troubled charities may seek to reorganize their debts, charities cannot be forced into involuntary bankruptcy. See J.P. O'NEILL & S. BARNETT, COLLEGES AND CORPORATE CHANGE: MERGER, BANKRUPTCY, AND CLOSURE app.2, at 127-99 (1980) (giving state-by-state summary of the required processes of nonprofit dissolution).

84. Hilgert, *supra* note 66, at 126-27 tbl.1. Once again, as discussed in note 67 and accompanying text, this figure includes the liabilities of T.I.A.A./C.R.E.F.

liabilities."⁸⁵

Offsetting these liabilities, however, in addition to the investment assets described above, are a reported total of \$503.5 billion in operating assets: land, buildings, and equipment of \$256.5 billion (probably low, because they are reported at book value rather than fair market value); \$85 billion in cash and temporary investments; and \$162 billion in receivables (accounts, pledges, grants, and loans) and other assets. Operating charities' total "fund balance" (net worth) was \$487 billion; adding in \$163 billion for private foundations brings total charitable net worth (excluding churches) to \$650 billion.⁸⁶ Total charity liabilities thus fall short of *either* investment assets or operating assets. Even if charities cannot borrow directly against endowment, an endowment makes it easier to borrow; an endowment frees up other assets and revenue streams that might be used as security, and earns the charity a higher credit rating on its debt, permitting it to borrow at a lower interest rate.⁸⁷ We can accordingly view the use of debt as anticipating endowment corpus economically, even if not technically.

Charity borrowing has a long history. In the Middle Ages, when admittedly the Church functioned more as a sovereign than as a charity, Rome needed increasing revenues to finance the crusades as well as its wars with secular powers. Despite common beliefs about usury prohibitions,⁸⁸ "the fact remains that

85. *Id.* In addition, small reporting charities list total liabilities (undifferentiated) of approximately \$224 million. *Id.* at 133 tbl.4. One study of Boston hospitals found that their long-term debt accounted for 41% of their sources of cash (operating income accounted for 43%, and donations and investment income 16%). Kane, *supra* note 58, at tbl.2 (Sources of Cash—12 Boston Hospitals, 1984–92). These numbers exclude the activities of affiliates; "multiple entities," Kane concluded, "make[] analysis of the financial resources of 'hospitals' very difficult. The boundaries of the 'entity' are not black and white." *Id.* at 18.

86. Hilgert, *supra* note 66, at 126–27 tbl.1. In the same year, private foundations reported \$7.5 billion in liabilities, but also \$4 billion in "charitable purpose land, buildings and equipment" plus another \$16 billion in cash and temporary investments. Arnsberger, *supra* note 68, at 136–37 tbl.3.

87. See, e.g., *Five Institutions Receive Upgrades, Two Are Downgraded*, BUS. WIRE, July 26, 1996 (applying Moody's "favorable outlook...for flagship public universities that do not rely heavily on state appropriations and have amassed significant financial resources" including large endowments; and downgrading institutions "that rely heavily on federal research funding or that have a large health care component, if they lack superior balance sheet reserves or are unable to adapt quickly to federal cuts"); Constance Hays, *With Bonds, Colleges Can Get Topsy-Turvy*, N.Y. TIMES, Mar. 9, 1997, § 3, at 6 (describing how rating agencies base bond ratings on endowment and other assets, among other factors); *Higher Education and Other Not-for-Profit New Issues Ratings Increase in First Half of 1996*. Compare Linzer, *supra* note 7, at 5 ("Restricted from the onset, endowment funds cannot serve as collateral, or be pledged or leveraged in any way."), with Tuckman & Chang, *supra* note 74, at 262.

88. The practice of the medieval English ecclesiastical courts to enforce usury restrictions only against loans carrying high rates of interest formed the underpinnings of the Tudor secular legislation to treat loans charging less than 10% as merely forfeitable (and in practice allowable). R.H. Helmholz, *Usury and the Medieval English Church Courts*, 61

the Church from the twelfth to the sixteenth century, from the lowest clergy to the papacy, existed by some form of credit financing."⁸⁹ The clergy, "instead of paying off debts and running their parishes economically, had plunged into debt (especially over lavish building programmes) and taken out mortgages on property."⁹⁰ A decree of the Church's thirteenth general council, held in Lyons in 1245, reveals deep ambivalence toward borrowing that sounds familiar to modern ears:

The unfathomable greed of usury has brought many churches to the verge of destruction.... [I]f there is pressing need, or if some reasonable benefit of the churches should demand it, prelates with the consent and advice of their superiors, and archbishops and exempt abbots...may contract debts that are not usurious, if it can be done, but never may they contract them on the open market.... Furthermore the privileges of churches are not to be given as security...; nor may other properties of the churches be given except for necessary and beneficial debts contracted in the aforesaid manner.⁹¹

SPECULUM 364, 379-80 (1986). I am grateful to Charles J. Reid, Jr. for this reference.

89. JOHN GILCHRIST, *THE CHURCH AND ECONOMIC ACTIVITY IN THE MIDDLE AGES* 107 (1962).

90. *Id.* at 108.

91. Lyons (1245), *Constitution [I]: On Usury*, in GILCHRIST, *supra* note 89, at 189, 190-91. Detailed records maintained by the Canterbury Cathedral Priory throughout the thirteenth century demonstrate why and how one monastery incurred and repaid debt. The priory financed its operating expenses, as well as land reclamation and other productivity costs, out of the normal manorial revenues. Mavis Mate, *The Indebtedness of Canterbury Cathedral Priory 1215-95*, 26 *ECON. HIST. REV.* (2d ser.) 183, 193 (1973). However, two contentious elections of a new archbishop of Canterbury, and later charges of misconduct and other disputes, required costly negotiations at Rome. The "high cost of conducting business at the papal court frequently forced the priory to borrow from Italian merchants, who alone were able to lend money in Italian coin at Rome and accept repayment in English coin at London." *Id.* at 184. "It was dangerous to carry large quantities of silver coin across Europe, and instead the monks carried letters from Italian merchants living in London to their companions at Rome, asking them to make the required loan." *Id.* at 192. The monastery ordered its representatives "not to fritter away their money in bribes to cardinals indiscriminately," but rather to concentrate their payments on the pope and those cardinals who likely would help. *Id.* at 187-88 (quoting C.E. WOODRUFF & WILLIAM DANKS, *MEMORIALS OF CANTERBURY CATHEDRAL* 130-32 (1912)).

In the 1270s, the priory borrowed mostly from neighboring landowners, nominally interest-free but for more than religious quid pro quos.

The spiritual services provided by the priory, the employment of relatives, the need for a safe deposit, or simply the desire to help the priory in time of need, were, together or singly, clearly sufficient inducement for a significant number of private friends to lend large sums to Canterbury Cathedral Priory.

Id. at 190. For unexplained reasons, revenues from monastic manors almost doubled between 1284 and 1300, permitting the priory to erase thousands of pounds of debt owed to the Italian lenders and begin the new century with a surplus. *Id.* at 193.

D. The Players

Whose idea is the perpetual term of the typical charitable trust or endowment? Suspicion falls naturally upon the donor. Observers conceive of Propertied Man as seeking to compensate for human mortality. Think of the medieval perpetual "obit," the masses for the dead.⁹² Indeed, in England prior to the Norman invasion, Anglo-Saxon law treated a gift as a contract, thus requiring counterperformance:

The men of this world want things in the next; while the men of the next world want things in this.... The gift of the laymen is land; the gift of the clergy is the care of the soul by spiritual services...; and, moreover,...donors...are thinking of their souls and buying a secure and lasting place for them in the world to come.⁹³

A perpetual charity, however, must eventually be carried out by persons other than the founder. Sometimes lost in the veneration of perpetual charities is the very real mortality of the human beings who constitute them. Donors, trustees, directors, and officers—as well as the beneficiaries and clients—all come and go, as fate and circumstances dictate. The various players making up "the charity" have their own, possibly diverging, interests.⁹⁴

Over the centuries, the secularization and democratization of support for charity enlarged the conception of who qualifies to manage a charity, as well as who qualifies as a beneficiary. In medieval England, making a gift to the poor was part of practicing religion, and the bishops and priests administered charity. The twelfth and thirteenth centuries brought a host of hospital foundations by private benefactors: "Kings, bishops, feudal lords, wealthy merchants, guilds, and municipalities all endowed houses of charity."⁹⁵ Medieval "hospitals" included

92. A nonmilitary tenure called "frankalmoin" resulted when land was granted to a religious person or institution "in free, pure, and perpetual alms." The grantee took on the obligation to pray for the soul of the grantor and his ancestors. The statute of *Quia Emptores* abolished frankalmoin in 1290. A.W.B. SIMPSON, *A HISTORY OF THE LAND LAW* 10–11 (2d ed. 1986).

93. H.D. Hazeltine, *Introduction*, *ANGLO-SAXON WILLS* xx (Dorothy Whitelock ed. & trans., 1930, reprinted 1986). This collection includes a will, dated circa 958, declaring: "I, Æthelgeard, grant the estate at Sotwell after my death to my wife for her lifetime, and then for the need of the souls of both of us to the New Minster in Winchester, for them to use and never to alienate." *Id.* at 19 & 116 n.VI; see also PAUL LANGFORD, *PUBLIC LIFE AND THE PROPRIETED ENGLISHMAN, 1689–1798*, at 491 (1991) (writing of eighteenth-century major benefactions: "'Proud and ostentatious Charity,' designed to immortalize the benefactor, seemed only one remove from the despised pre-Reformation mentality of donations for prayers to save the donor's soul.").

94. See generally Evelyn Brody, *Agents Without Principals: The Economic Convergence of the Nonprofit and For-Profit Organizational Forms*, 40 *N.Y.L. SCH. L. REV.* 457 (1996). For example, Hansmann observes that university trustees seem to favor endowment growth, while faculty often prefer increased current spending. Hansmann, *supra* note 20, at 37.

95. BRIAN TIERNEY, *MEDIEVAL POOR LAW* 85 (1959).

general almshouses for "indoor" (resident) and "outdoor" (doles and pensions) poor relief, homes for the old and invalid, orphanages, lying-in hospitals, and leper colonies. More than 600 such institutions existed in England by the middle of the fourteenth century.⁹⁶ A papal decree on hospital law, issued in 1311, provided an explicit statement on the inviolability of the charity's resources. The decretal established a procedure for bishops merely to audit hospital administration, and explicitly determined that the wardenship of a hospital did not constitute an ecclesiastical benefice.⁹⁷

The English Reformation invalidated gifts made for "superstitious uses" (such Catholic practices as masses for the dead, and gifts in connection with relics and the veneration of saints), requiring the redirection of charitable resources.⁹⁸ Modern charities more commonly provide peer-group benefits than poor relief. As discussed in Part II, below, the eighteenth century created a philanthropic world, still recognizable today, of dues-paying members, charity dinners, and high-pressure, high-society fund raising—with the most familiar feature of associative charity, the separation of donors from professional administration.⁹⁹ The American community foundation movement similarly reduces donor control by permitting professional managers, within general donor-determined outlines, to calibrate gifts to contemporary needs.¹⁰⁰

Donors rarely act alone in deciding to restrict donations. The legal structure, however, masks the role of advisors, by viewing trustees as merely carrying out the wishes of the donor.¹⁰¹ (In many cases, of course, the big donors and the trustees are the same people.) In asking why universities maintain endowments, Henry Hansmann takes the point of view of existing universities with

96. *Id.* at 86.

97. "That meant not only that a layman could have charge of a hospital, but also that its revenues could not be diverted from the purpose intended by the founder to provide a handsome income for some worthy or fortunate cleric." *Id.* at 86.

98. See generally KEETON, *supra* note 17, at 55. A Victorian observed: "When...you talk of 'disappointing the will of the original donor,' remember how many souls are suffering in purgatory at this moment for want of the masses which they gave their property to obtain." KENNY, *supra* note 15, at 186 n.† (quoting his contemporary, O'Connell).

99. See also Elizabeth T. Boris, *Working in Philanthropic Foundations*, in PHILANTHROPIC GIVING: STUDIES IN VARIETIES AND GOALS, *supra* note 31, at 200, 205 (developing four models to describe the relative power among the donor, board, and staff).

100. Kathleen D. McCarthy, *The Gospel of Wealth: American Giving in Theory and Practice*, in PHILANTHROPIC GIVING: STUDIES IN VARIETIES AND GOALS, *supra* note 31, at 46, 55.

101. See Francie Ostrower, *The Role of Advisors to the Wealthy*, in AMERICA'S WEALTHY AND THE FUTURE OF FOUNDATIONS 247, 260 (Teresa Odendahl ed., 1987) (One attorney's European clients are more used to thinking about the significance of a perpetuity than his American clients: "This is a very young country.... I try to see if their priorities are consistent with the idea of creating a fund that can adapt to change over a very, very long period of time."); see also TERESA ODENDAHL, CHARITY BEGINS AT HOME 209, 219 (1990) ("Development and trust officers, like attorneys, tend to give advice that channels donations in the direction of established, prestigious, highly endowed institutions.")

incumbent trustees.¹⁰² Only secondarily does he turn an inquiring eye to private donors, who "seem so fond of contributing to endowment."¹⁰³ The motives of both donors and trustees are explored in detail in Part III, *infra*.

Trustees themselves often decide to treat an unrestricted, or vaguely restricted, contribution as a perpetuity.¹⁰⁴ For example, the trust established by the 1657 will of Edward Hopkins, an early benefactor of Harvard, restricts the purpose of the fund, but does not explicitly limit the payout to income only over time.¹⁰⁵ Its trustees used the bulk of the funds to buy income-producing land, the rents from which were to fund scholarships into perpetuity; the trustees further capitalized some income each year.¹⁰⁶

Charitable endowments can increase in value over the years. Shortly after passage of the monumental Elizabethan Statute of Charitable Uses in 1601, disputes arose over who was entitled to the increase in rents from gifts of land—did the increase also go to the charitable use, or could the donor's heirs claim the surplus? "[I]n every reported case before the beginning of the eighteenth century, the charity was given the benefit of the increase in value."¹⁰⁷

102. Hansmann, *supra* note 20.

103. *Id.* at 31; *see also id.* at 32–35.

104. Professor John Simon found that donative transfers to most large foundations did not contain income-only restrictions, but that foundation managers nevertheless treat these funds as endowment. John G. Simon, *The Tax Treatment of Nonprofit Organizations: A Review of Federal and State Policies*, in *THE NONPROFIT SECTOR: A RESEARCH HANDBOOK* 60, 80 n.24 (Walter W. Powell ed., 1987). Professor Hansmann comments: "Since these institutions have already received the one and only donation they will ever get, such behavior can no more be ascribed to encouragement of further gifts than to compliance with the intentions of the founder." Hansmann, *supra* note 20, at 34.

105. *The Will of Edward Hopkins*, in CHARLES P. BOWDITCH, *AN ACCOUNT OF THE TRUST ADMINISTERED BY THE TRUSTEES OF THE CHARITY OF EDWARD HOPKINS* 52, 53 (1889) ("to give some Encouragement unto those forreign Plantations for the breeding up of Hopefull youth in the way of Learning both at the Gramar School & Colledge for the publick Service of the Country in future times" (abbreviations spelled out)). I am grateful to Peter Dobkin Hall for bringing this document to my attention.

106. BOWDITCH, *supra* note 105, at 29, states:

For a long time the Trustees considered that they had the right, in their discretion, to lay aside each year such part of the income as they saw fit, for the purpose of increasing the principal of the fund; and having decided upon what the net income should be, they considered that the portion available for theological students could be apportioned to such a number of students, and in such proportion, as seemed best to them.

Similarly, Harvard treasurer Thomas Brattle (who died in 1713) made a practice of "capitalizing" rather than spending most unrestricted gifts. FOSTER, *supra* note 40, at 184.

107. GARETH JONES, *HISTORY OF THE LAW OF CHARITY* 92 (1969). Jones found that:

the courts established a principle of deceptive simplicity: namely did the testator intend when he made his will to devise the whole of the land's rent at any time to charity; or was his intention merely to devise to charity a fixed sum of money, which happened to be the annual value of the land

But what is meant by "charity?" The administrative apparatus as well as charitable activities can grow with increasing resources. Charity managers must decide what to do with this surplus. Self-dealing is clearly illegal; more invidiously, some managers apply the growth to the amenities of their office, or to carry out their preferred social ends.¹⁰⁸

at his death?

Id. One case, appealed all the way to Parliament, is digested by DUKE, *supra* note 24, at 71-72, as follows:

Case 10. The School of *Thetford's* Case upon a Bill exhibited in Parliament, 8 *Jac.* 8 *Coke* fol. 130.

Land of the value of 35 *l.* by the year, was, by Sir Thomas Fulmerston 9 Eliz. Devised to certin persons in Trust, and their heirs, for maintainance of a Preacher, Schoolmaster, and poor People, in *Thetford*, and by the Will, a special distribution was made, how much the Preacher, Schoolmaster, and Poor should have, amounting in the whole unto 35 *l.* by the year, which was the value of the Land at the time of the Devise, and afterwards the Land increaseth to be by the value of 100 *l.* by the year, and upon a Reference to the Chief Justices, and Judge *Walmsley*, they certified their opinions, that the Revenue of the Lands shall be employed to increase the several stipends of the persons appointed to be maintained by the Devise, and if any surplusage do remain, it shall be employed for the maintainance of a great number of people, and nothing shall be converted by the Devisees, to their own use, for that it appeareth by the distribution of the Devisor, that he intended that all the Profits of his Lands, shall be employed in the *Charitable Works* by him funded, and left nothing to his Heirs or Executors, of the Profits of his Lands, as they were in value at his death, and as if the value of the Land had decreased, the Poor should have lost in their stipends, so when the Revenue of the Lands increase, they shall gain; and the Lord *Coke* said, That this Resolution did concern all the Colledges in the Universities, and elsewhere; for when the Lands were first given for their maintainance, and that every Scholar should have a Penny-halfpenny a day, this was then a competent allowance for a Scholar, in respect of the price of Victuals then, and yearly value of the Land, and now the price of Victuals being increased, the first maintainance for Scholars, is not competent for them; and as the value of the Lands increase, so ought the Allowance for the Scholars to increase; for the Colledges seized in *Jure Collegii*, to the intent, that the Members of the Colledge shall be maintained, according to the intent of the Founder, which is, that all the Revenue and Increase of the Profits of their Lands, shall be bestowed in the Works of *Charity*, which the Founder hath expressed, and that nothing should be committed to any other private uses, for *panis egentum est vita pauperum, & qui defraudat eos homo sanguinis est*, and upon conference with all the Judges of *England*, they agreed to the Opinion of both the aforesaid Judges, and both Houses of Parliament passed the Bill accordingly, and the King assented to the Bill.

108. The Victorian reformer Courtney Kenny derided incumbent charity managers for hiding behind the flag of donor sanctity in doing whatever they really wanted. Kenny cites, among other cases, the endowment of Christ Hospital, given to educate poor boys and girls, but in 1865 educating 1100 boys and only 25 girls, and most of them middle class.

Anthony Trollope based his 1855 novel, *The Warden*, on contemporary scandals in the charitable sector.¹⁰⁹ Trollope presents an example of a medieval trust whose income by Victorian times overwhelmed the specified purposes of the founder:

In the year 1434 there died at Barchester one John Hiram, who had made money in the town as a woolstapler, and in his will he left the house in which he died and certain meadows and closes near the town, still called Hiram's Butts, and Hiram's Patch, for the support of twelve superannuated wool-carders....

From that day to this the charity has gone on and prospered—at least the charity had gone on, and the estates had prospered. Wool-carding in Barchester there was no longer any; so the bishop, dean, and warden...generally appointed some hangers-on of their own; worn-out gardeners, decrepit grave-diggers, or octogenarian sextons, who thankfully received a comfortable lodging, and one shilling and fourpence a day, such being the stipend to which, under the will of John Hiram, they were declared to be entitled.¹¹⁰

In the early years, the property barely supported these annuities, and the warden, too, scraped by, but the property eventually turned prosperous. The men continued to draw their shilling and fourpence, while the warden's stipend now stood at £800 a year.¹¹¹ The warden, while not wanting to challenge his bishop's right to appoint the patronage, worried, "Was John Hiram's will fairly carried out...? [A]nd if not, was it not his especial duty to see that this was done...?"¹¹² However, the "bishop had an indistinct idea that [the will provisions] altered themselves by the lapse of years; that a kind of ecclesiastical statute of limitations barred the rights of the twelve bedesmen to any increase of income arising from the

KENNY, *supra* note 15, at 183–84 & n.*.

109. ANTHONY TROLLOPE, *THE WARDEN* 8 (Everyman Library 1991):

Eager pushing politicians have asserted in the House of Commons...that the grasping priests of the Church of England are gorged with the wealth which the charity of former times has left for the solace of the aged, or the education of the young. The well-known case of the Hospital of St. Cross, has even come before the law courts of the country, and the struggles of Mr. Whiston, at Rochester, have met with sympathy and support.

The warden of St. Cross supplemented his salary (of thousands of pounds) by leasing out some of the almshouse's property and keeping the rent; after disclosure in the press, he made restitution and resigned. Robert Whiston, headmaster of the Cathedral Grammar School at Rochester, was fired after complaining that the Dean and chapter were appropriating school funds; Whiston won reinstatement in court. Graham Handley, *Introduction to TROLLOPE, supra*, at vii–viii.

110. TROLLOPE, *supra* note 109, at 2–3.

111. "In bad times the poor men had had their due, and therefore in good times they could expect no more.... In this manner...the office had become one of the most coveted of the snug clerical sinecures attached to our church." *Id.* at 4.

112. *Id.* at 26.

increased value of property."¹¹³ It seems not to have occurred to anyone that the surplus might be used to serve additional beneficiaries, or be transferred to other charities that could.

II. DEFINING DEVELOPMENTS IN THE LAW OF CHARITABLE ENDOWMENTS

This Part of the Article examines four significant legal events or themes aimed at constricting the scope of charitable endowments in Anglo-American history. We begin with land law, focusing on the mortmain restrictions that prevented the transfer of land to charitable corporations. These limitations have essentially died out in England and in the United States. Next we look at perhaps the most dramatic instance of a politically popular seizure of charitable assets: Henry VIII's dissolution of the monasteries. Third, we describe the emergence and growth of subscription charity as an alternative to endowed financing. We conclude by focusing on charity in America, and the modern tax rules requiring private foundations to make minimum (and minimal) distributions for charitable purposes.

A. *The Legal Treatment of Land: Mortmain Restrictions*

It can be difficult today to understand the long struggle of society to define and allocate property rights. We take for granted that individuals can alienate their property, real and personal, to whomever they please. We puzzle over statutes that grant corporations perpetual life, as if a shorter life could never make sense, and we wonder also why statutes need to grant corporations the power to purchase and alienate real property. Such freedoms were not, however, achieved easily and without cost. Those who advocate plenary ownership powers need to rationalize how "ownership" is divided over time and among members of the family, and what limits are to be imposed on the power of any particular generation to disinherit widows and children in favor of third parties, including charities.¹¹⁴

1. *The English Mortmain Laws*

a. *The Demands of the Feudal System*

The English legal system long treated land differently from money and other personalty, in large part for reasons that trace back to the peculiarities of feudal tenure.¹¹⁵ Established after the Norman Conquest, feudal tenures were a type

113. *Id.* at 28–29.

114. As historian Howard Miller comments, the common law verities of "individual rights" and "private property" can support opposing legal treatments of philanthropy: "Because some [judges and legislators] thought that charities were beneficial, while others were convinced that they were dangerous, lawmakers often arrived at opposite conclusions from identical premises respecting personal and property rights." HOWARD S. MILLER, *THE LEGAL FOUNDATIONS OF AMERICAN PHILANTHROPY, 1776–1844*, at 41 (1961).

115. See Fred Bosselman, *Four Land Ethics: Order, Reform, Responsibility, Opportunity*, 24 ENVTL. LAW 1439, 1441–57 (1994).

of contract. (The best known, the Magna Carta ("Great Charter") of 1215, was a compact between King John and the barons.) To be precise, the feudal tenure "involved...both a personal relationship between superior and inferior, lord and vassal, marked by reciprocal duties of protection and service, and the granting of a benefice, that is, a parcel of landed estate to be enjoyed upon favorable terms, so long as the service due was faithfully performed."¹¹⁶ The feudal obligations originally consisted of knight service, but also included, and eventually commuted to, monetary payments (called "fines"). Fines were due upon the death of the tenant, as well as when the land descended to a minor, who could not personally perform feudal services ("wardship").¹¹⁷ Tenants also forfeited the land to the lord by engaging in treason (a not uncommon occurrence in those risky days) or by committing some other felony.

The value of feudal services explains why transferring land to the Church or other corporate charity presented such a threat. Corporations never die, leave minor heirs, or commit treason, let alone ride out into battle. As a result, a transfer of land to the Church falls into a dead hand (mortmain).¹¹⁸ The Magna Carta prohibited an alienation of land (by gift or sale) if the transferor did not retain enough to render service to the lord. This provision attacked collusive arrangements between a tenant and the Church to defeat the payment of fines. Tenants would grant their land to the Church while retaining a right to occupy and obtain regrant. Later, the 1279 statute *De Viris Religiosis* rendered any land granted to a religious body forfeitable upon the action of the mesne lord. A license to alienate in mortmain could, however, be readily obtained from the Crown.¹¹⁹ Petitions "ad quod damnum" ("to what harm") quantified the lost revenues from a proposed transfer, and, if the license was granted, permitted the landowner to pay the monetary equivalent as a condition to the transfer.¹²⁰ However, "[w]hat in effect checked excesses of piety in the medieval period was the inability to devise land."¹²¹

The law of primogeniture mandated that title in land passed at death to the

116. SIMPSON, *supra* note 92, at 2.

117. See Charles J. Reid, Jr., *The Seventeenth-Century Revolution in the English Land Law*, 43 CLEV. ST. L. REV. 221, 234-42 (1995); see also EILEEN SPRING, *LAW, LAND, AND FAMILY: ARISTOCRATIC INHERITANCE IN ENGLAND, 1300 TO 1800*, at 31 (1993).

118. SIMPSON, *supra* note 92, at 53-54.

119. *Id.* at 55-56. The legislature could also grant licenses. For example, in 1597, Parliament passed an "[a]ct for erecting of hospitals or abiding and working houses for the poor." 39 Eliz., ch. 5 (1597) (Eng.). This statute permitted donors to give or devise lands in fee simple (without having to secure a royal license or act of parliament to achieve incorporation), as long as the annual value of the endowment was at least £10.

120. For all transfers other than those in mortmain, the 1290 statute of *Quia Emptores* confirmed that property could be alienated in fee, but provided that the transferee took subject to the feudal servitudes. Professor Simpson observes: "This solution to the problem is a striking illustration of the lack of importance which by this time was attached to the personal relationship of lord and tenant; lords were more interested in protecting their incidents than in selecting their tenants." SIMPSON, *supra* note 92, at 54-55.

121. *Id.* at 55.

oldest son (personal property could be otherwise alienated). Property owners desiring to circumvent this restriction granted beneficial “uses” in the land. By Henry V’s time, most of the land in England was held in use.¹²² In response, Parliament adopted the Statute of Uses in 1536 (under Henry VIII)¹²³ and the Statute of Charitable Uses in 1601 (under Elizabeth I).¹²⁴ The rule against perpetuities essentially requires outright ownership of property to vest no later than in the first unborn generation,¹²⁵ thus preventing a testator from dictating beneficial enjoyment long after death.¹²⁶ However, the Statutes of Charitable Uses created an exception for transfers to perpetual charitable trusts.¹²⁷ In an early collection of cases prosecuted under the Statute of Charitable Uses, nearly every case involved a devise of land, or of land and improvements.¹²⁸

122. See FREMONT-SMITH, *supra* note 14, at 20.

123. 27 Hen. 8, ch. 10 (1536) (Eng.). The restoration of primogeniture as the exclusive means for transferring real property provoked such a protest that in 1540 Parliament enacted the Statute of Wills; thereafter, landowners could dispose of freehold estates by will, except for tenants by knights-service, who had to leave at least one-third to descend. Reid, *supra* note 117.

124. 43 Eliz., ch. 4 (1601) (Eng.).

125. SPRING, *supra* note 117, at 130 (“the rule against perpetuities...in essence forbade that unborn persons be reduced to life tenancies”).

126. After England abolished primogeniture, families sought other ways to ensure that land passed undivided to the first son. The practice of “strict settlement” was “a system of making and remaking settlements each generation between father and son, [so that] a family estate might be made to descend generation after generation from one life tenant to another despite the rule against perpetuities.” *Id.* at 124. A father possessing a life interest and the son an entail would agree upon the son’s marriage to make a settlement to the son’s own (future) son, while retaining a life interest. Why would the son agree to this? “The son would be in need of an income for himself and his wife during the years before he would succeed to the inheritance.” *Id.* at 125. The poet Percy Bysshe Shelley—appropriately descended from the subject of the Rule in Shelley’s case—rebelled at having to make a settlement in favor of an unknown child. He tried instead to borrow against his future interest, but other, even more complex, legal barriers severely reduced the monetary value of his entitlement. He reluctantly capitulated, and resettled the estate. *Id.* at 125–26.

127. To be precise, 39 Eliz., ch. 5 (1597) (Eng.), permitted charitable trusts to have perpetual life. The subsequent Statute of Charitable Uses, 43 Eliz., ch. 4 (1601) (Eng.), “provided machinery for the enforcement of charitable trusts.” See FREMONT-SMITH, *supra* note 14, at 23–27. The 1601 statute was itself a reenactment, with amendments, of a 1597 statute, “An Acte to reforme Deceits and Breaches of Trust, touching Lands given to Charitable Uses.” The preamble to this earlier version declared that charitable funds “have bene and are still likely to be most unlawfully and uncharitably converted to the lucre and gayne of some fewe greedy and covetous persons, contrary to the true intente and meaning of the givers and disposers thereof.” 39 Eliz., ch. 6 (1597) (Eng.), *quoted in* JONES, *supra* note 107, at 22.

128. DUKE, *supra* note 24. Some English benefactors donated a “rent charge”—a fixed sum required to be paid annually to a charitable cause or trustee out of the income of the land, which remained in private hands. JORDAN, *supra* note 14, at 121 & n.2 (these fixed amounts declined in real value over time, and many of these charges against the land were “redeemed” by a payment to charity, often without resort to court).

b. Fears of Inalienability

The problem of inalienability is technically separate from, although aggravated by, the problem of mortmain. After all, if the charity later sold the land to an individual, property would reenter the realm of the living and feudal fines could again be paid. However, the Church, like other investors, sought to hold property in the form of land.¹²⁹ Courtney Kenny, writing in 1880, described the problems raised by inalienable land:

All inalienability causes both economical and political evil to the country at large.... A commodity so strictly limited in quantity as land is, should be rendered as freely transferable as possible, that the limits of the supply may not be artificially narrowed. Lord Hardwicke...reminded the Lords of the difficulty which their ancestors found in obtaining estates in the days when "the church and perpetual charities had above half the lands."¹³⁰

One nineteenth-century barrister complained that fears of concentrated inalienability are unfounded because no law prohibits the church or other charities from selling their land.¹³¹ While indeed the modern Canon Code confirms the Church's power to alienate,¹³² this was not always so. Both the Roman Law and

129. Professor Gilchrist traces the inalienability of ecclesiastical land to the Church's imposition of celibacy. Without families, the priests had to be provided for. GILCHRIST, *supra* note 89, at 99.

130. KENNY, *supra* note 15, at 80 (footnotes omitted).

131. WILLIAM F. FINLASON, AN ESSAY ON THE HISTORY AND EFFECTS OF THE LAWS OF MORTMAIN, AND THE LAWS AGAINST TESTAMENTARY DISPOSITIONS FOR PIOUS PURPOSES 31 (1853).

132. The modern Canon Code uses the word "alienate" as a term of art. Commentary states:

In the strict sense, alienation applies to real property and to invested funds which are similar to immovable property. These latter funds are termed *stable capital* or *fixed capital* and consist of funds invested for a specified purpose. They may become stable capital either by formal designation as such by the proper ecclesiastical authority or by the intention of the donor who gives the funds for a specific purpose.

....

Most real property of public juridic persons is subject to the canons on alienation. Land and buildings generally fall under these regulations. So also do objects of special worth for artistic or historical reasons, objects blessed or consecrated for use in worship, and anything given to the Church as a votive offering.

THE CODE OF CANON LAW: A TEXT AND COMMENTARY 879, at 1983 CODE c.1291, cmt. (James A. Coriden et al. eds., 1985) (footnotes omitted). For example, general commentary following Title III ("Contracts and Alienation in Particular") states: "If property, including stocks and bonds, is exchanged for property of approximately equal value, no alienation occurs. Transfer of title in exchange for something in a different category, however, is alienation.... The Code, however, seems to consider any sale of real estate as alienation and subject to the regulations." *Id.* at 883.

Canon 1292 sets forth the procedures required for alienation, applying, in general,

medieval canon law prohibited the alienation of all church property, "i.e., lands, permanent fixtures, buildings, churches, hospitals, and even annuities left by will," except in cases of necessity, such as to pay debts.¹³³ Moreover, inalienability "was once a universal attribute" of charity in England because "various statutes were passed to restrain alienations by ecclesiastical and eleemosynary corporations, whilst the rules of Equity made it utterly unsafe for unincorporated charity trustees to sell any land without obtaining the consent of the Court of Chancery."¹³⁴ Finally, land ownership in England used to confer electoral privileges.¹³⁵

c. The 1736 "Modern Law of Mortmain"

England abolished feudal dues and granted the full power of devise at the time of the Commonwealth.¹³⁶ Nevertheless, under George II, Parliament enacted a perplexingly tough and poorly drafted statute, misnamed the Modern Law of Mortmain.¹³⁷ Commentators tell two different stories about this statute. One line of scholarship cannot find any explanation for the law.¹³⁸ The other finds a strong anticlerical feeling in Parliament.¹³⁹

a sliding scale of amounts requiring higher levels of approval. See 1983 CODE c.1292. Commentary to canon 1291, however, urges the conference of bishops to "set down guidelines and definitions which would, in effect, create the flexible, workable notions which are badly needed." Specifically, "[t]he conference could establish what kinds of transactions, even within the realm of stable capital, are really only ordinary management activities. It could also clarify the limits to borrowing on an extended line-of-credit beyond which higher consultation is needed." THE CODE OF CANON LAW: A TEXT AND COMMENTARY, *supra*, at 880.

133. GILCHRIST, *supra* note 89, at 36. Book V of the modern Canon code, which deals with the temporal goods of the church, states at the outset: "The Catholic Church has an innate right to acquire, retain, administer and alienate temporal goods in pursuit of its proper ends independently of civil power." 1983 CODE c.1254, § 1.

134. KENNY, *supra* note 15, at 81 (footnote omitted).

135. See *id.* at 84 ("Thus Lord Grey tells us that Greenwich Hospital 'used to be one of the great [electioneering] interests in the county. It was one of the great objects of any candidate there to secure that interest.'" (footnote omitted)).

136. Parliament abolished the feudal incidents, as well as the unpopular Court of Wards, in 1645 (the "Statute of Tenures"). Reid, *supra* note 117, at 241-42.

137. 9 Geo. 2, ch. 36 (1736) (Eng.), reprinted in JONES, *supra* note 107, app. J at 257. For a discussion of the various English mortmain laws, and digests of cases, see ANTHONY HIGHMORE, A SUCCINCT VIEW OF THE HISTORY OF MORTMAIN AND THE STATUTES RELATIVE TO CHARITABLE USES (2d ed. 1809); and LEONARD SHELFORD, A PRACTICAL TREATISE OF THE LAW OF MORTMAIN, AND CHARITABLE USES AND TRUSTS (1842). See also FINLASON, *supra* note 131, at ii.

138. See the legislative report of the Mortmain Commission of 1844, reprinted in FINLASON, *supra* note 131, app. at 170.

139. "The spirit of that time, with its reaction against ecclesiastical tradition, is doubly manifest, for good or evil, in the legislation of 1736. The same session which saw the laws against witchcraft repealed, saw a statute passed to check charitable donations." KENNY, *supra* note 15, at 58. In later granting exemption to Queen Anne's Bounty for "'the endowment or augmentation of the income' of clergymen of the Established Church," Parliament demonstrated that this anticlerical feeling was really anti-Catholic. See *id.* at 68-69 (quoting 6 & 7 Vict., ch. 37, § 22 (1843) (Eng.)).

The preamble to the 1736 legislation began by invoking the traditional mortmain concern, but ended on an altogether different worry—that testators might cut off heirs:

*Whereas gifts or alienations of lands, tenements, or hereditaments in Mortmain, are prohibited or restrained by Magna Charta and divers other wholesome laws, as prejudicial to and against the common utility; nevertheless this publick mischief has of late greatly increased by many large and improvident alienations or dispositions made by languishing or dying persons, or by other persons, to uses called Charitable uses, to take place after their death, to the disherison of their lawful heirs....*¹⁴⁰

First, the 1736 statute barred devises of land for any charitable purpose. Second, any inter vivos gift to charity had to be made outright and absolutely, at least twelve months before the donor's death, and enrolled in the chancery court within six months of execution.¹⁴¹ The drafters believed that landowners were unlikely to take the financial risk of making outright lifetime gifts, while once on their deathbed they might forget the natural claims of their heirs in yielding to religious or charitable motives (a testator could still devise to anyone else!).¹⁴²

Finally, in general, no restriction applied to personal property: a testator

While Parliament considered the 1736 bill, Fielding's burlesque *Pasquin* was enjoying a successful run. Firebrand, the Priest of the Sun, declares as he rebels against Queen Commonsense:

Not for ambition's earthly cause,
But to enlarge the worship of the Sun;
To give his priests a just degree of Power,
And more than half the profits of the land.
Oh! my good Lord of Law, would'st thou assist,
In spite of Commonsense it might be done.

Id. at 63 (Kenny's emphasis).

140. 9 Geo. 2, ch. 36 (preamble), reprinted in JONES, *supra* note 107, app. J at 257. Gareth Jones reproduces some of the floor debates in Parliament. One member of the House of Lords declared:

[B]y the specious pretence of charity, the solicitations of those who are interested in charitable foundations, and the pride and vanity of donors, it is to me highly probable, that too great a part of the lands in this kingdom may soon come to be in Mortmain, to the prejudice of the nation in general, and to the ruin or unjust disappointment of many a man's poor relations, for I cannot but think that a man's heirs-at-law have some sort of natural right to succeed after his death, at least to his land estate.

JONES, *supra* note 107, at 110–11.

141. The donor could not retain a life estate, because this would have the effect of lifetime use followed by a devise. Evidently, the requirement of enrollment was not to publicize the gift for the public's benefit, but rather to smoke out any gifts to then-invalid superstitious uses (i.e., for Catholic practices). See FINLASON, *supra* note 131, at 92.

142. Cf. Adam J. Hirsch & William K.S. Wang, *A Qualitative Theory of the Dead Hand*, 68 IND. L.J. 1, 13 (1992) (discussing a general "moral hazard of testation" that results from testators' freedom "to behave as responsibly or irresponsibly as they choose, without bearing the interpersonal costs that living persons pay for eccentric behavior").

could completely disinherit heirs from personal property. To prevent game playing, however, the law also applied to personal estates related to land, such as leases or mortgages, or personalty "to be laid out" in land (that is, money willed for the purchase of land).¹⁴³ Accordingly, devises containing mixed features of personalty and real estate had to be sorted into the permissible and impermissible categories. Worse, as the decades rolled by, chancery courts strictly construed this statute, condemning personal property possessing any conceivable connection to real property, leaving "in a state of uncertainty" such emerging forms of property as "gas shares, canal shares, shares in banks, railways, docks, and in public companies."¹⁴⁴

Gareth Jones found the 1736 mortmain law symptomatic of a wholesale change in attitude towards private philanthropy. Courts, long lenient towards charity, "refused to presume that every donor, whose gift to charity had failed, had a 'general charitable intention' and sought to formulate rigid, analytical rules of construction."¹⁴⁵ In their eagerness to void charitable transfers under the new mortmain law, however, judges wound up maintaining, if not expanding, the definition of charity. "[P]aradoxically," wrote Jones:

it was the existence of the Mortmain Act, 1736, which preserved from serious questioning the inherited, generous conception of legal charity; for by classifying an object as charitable, the judges, who interpreted the statute "to repel the mischief, and advance the remedy," ensured that the devise to charity would be avoided and that the land would result to the heir-at-law or next-of-kin.¹⁴⁶

England did not repeal its basic mortmain prohibitions until 1960.¹⁴⁷ In an 1844 Parliamentary hearing, one witness complained that the inability of charities to accept devises of land "force[s] the policy of piety to exhaust itself in transitory objects instead of foundations which are permanent. Instead of investing moneys in permanent endowments we spend it within the year on different charities."¹⁴⁸ By

143. Lord Hardwicke said in *Attorney General v. Bowles*, 3 Atk. 206, 2 Vezey 547 (1754) that laying out money in lands "would leave open a door for every ostentatious weak person, who was fond of a name: the object is vanity, is a remnant of popery, which ought to be extinguished where the best religion in the world is exercised." HIGHMORE, *supra* note 137, at 222.

144. FINLASON, *supra* note 131, at 206 (digest of evidence of "Mr. Chapman, a conveyancer" to the select committee of the House of Commons, 1851-52, appointed to consider the policy of extending the Law of Mortmain to personal estate).

145. JONES, *supra* note 107, at 91.

146. *Id.* at 107-08 (footnote omitted).

147. The 1736 statute was modified in 54 & 55 Vict., ch. 73 (1891) (Eng.), which permitted land to be devised to charity if sold within one year after the death of the testator, unless retention was authorized by the court or the Charity Commissioners on the grounds that it would be used directly in a charitable activity rather than held for investment. All mortmain restrictions were abolished by the Charities Act, 1960, 8 & 9 Eliz. 2, ch. 58, § 38 (Eng.).

148. FINLASON, *supra* note 131, at 174 (digest of evidence of Sir Francis Palgrave to the select committee of the House of Commons, 1844, to inquire into the operation of the

contrast, John Stuart Mill had been proposing that English charities sell off all their land to the highest bidder, and “invest the proceeds in the stocks or other monied securities.”¹⁴⁹ A comfortable governor of a grammar school called this “the most astonishing madness that the imagination of mankind could conceive.”¹⁵⁰

2. *The American Experience*

Land provided a metaphor for intergenerational equity in the political philosophy of early American civic republicanism. Thomas Jefferson wrote to James Madison: “I set out on this ground, which I suppose to be self evident, ‘that the earth belongs in usufruct to the living’: that the dead have neither powers nor rights over it.”¹⁵¹ At the death of an owner of land, “the child, the legatee, or the creditor takes it, not by any natural right, but by the law of a society of which they are members, and to which they are subject.”¹⁵² Gregory Alexander concludes: “The doctrine that the earth belongs to the living...represented an attempt to create a public meaning for property in the new nation in terms of time. It depicted, figuratively through the naturalistic metaphor, American property...as freed from the past; dynamic, rather than static.”¹⁵³

The English mortmain laws never applied to the American colonies.¹⁵⁴ However, among the many customs inherited from England was a suspicion of the territorial ambitions of the Catholic Church and other charities. In Virginia, the disestablishment movement during the Revolutionary period challenged church-administered poor relief. Historian Howard Miller explains: “The political power of the church rested on its real estate holdings, and the same land supported its philanthropic activities.”¹⁵⁵ Not content with secularizing the management of poor relief by statute in 1806, the Virginia legislature denied charters of incorporation to

Laws of Mortmain).

149. Mill, *supra* note 38, at 25–26.

150. KENNY, *supra* note 15, at 97 (quoting from the Parliamentary Papers of 1873). Kenny reported the reluctance of charity trustees to “lose the dignities of landed proprietorship and the courtesies of the shooting season.” *Id.*

151. Letter from Thomas Jefferson to James Madison (Sept. 6, 1789), reprinted in 15 THE PAPERS OF THOMAS JEFFERSON 392 (J. Boyd ed., 1958), quoted in Gregory S. Alexander, *Time and Property in the American Republican Legal Culture*, 66 N.Y.U. L. REV. 273, 282 & n.25 (1991) [hereinafter Letter to James Madison]. Professor Alexander adds: “Jefferson went so far as to suggest that every constitution and every law naturally expires and must be either reenacted or revised at the end of nineteen years, which was, by his calculation, the life expectancy of a single generation.” Alexander, *supra*, at 282.

152. Letter to James Madison, *supra* note 151, in THE PAPERS OF THOMAS JEFFERSON, *supra* note 151, at 392.

153. Alexander, *supra* note 151, at 283. Professor Alexander characterizes Jefferson’s preference for agrarian land over nonvirtuous intangible and manufacturing property as “contributing to an extremely important eighteenth- and nineteenth-century American social myth—the myth of the garden.” *Id.* at 288, 301.

154. For example, colonial judges in Virginia held in one 1743 case: “The Devise of the Land in Virginia to a Charity is not Void” by the Mortmain Act of 1736, because the American colonies were not specifically mentioned in that act. MILLER, *supra* note 114, at 7.

155. *Id.*

numerous charities, religious and secular.¹⁵⁶

Then came the Supreme Court's 1819 decision in *Philadelphia Baptist Ass'n v. Hart's Executors*.¹⁵⁷ After the American revolution, some states had repealed English statutes, including the Statute of Charitable Uses. In *Hart*, the Supreme Court declared invalid charitable trusts in those states that failed to adopt replacement statutes.¹⁵⁸ Justice Joseph Story, in an anonymous explanatory note to the Supreme Court reports,¹⁵⁹ expanded his argument against unrestricted giving. Story praised the English Mortmain Law of 1736, and urged American legislatures to adopt similar controls in order

to prevent undue influence and imposition upon pious and feeble minds in their last moments, and to check that unhappy propensity which sometimes is found to exist under a bigoted enthusiasm, and the desire to gain fame as a religious devotee and benefactor, at the expense of all the natural claims of blood and parental duty to children.¹⁶⁰

The Virginia court eagerly embraced the result in *Hart*, invalidating a bequest to the Roman Catholic Chapel in Richmond.¹⁶¹ In his opinion, Henry Saint-George Tucker warned against unfettered bequests: "The church, if made capable to take, . . . never can part with any thing," and "advances with a step that never retrogrades."¹⁶² In contrast to business corporations, "charities never die"; "if the original object should fail, the attorney general and the master in chancery go to work to digest another scheme, cy pres the original intent of the donor." Tucker feared that the "whole property of society" would be "swallowed up in the insatiable gulph of public charities."¹⁶³ The Virginia Legislature pursued a restrictive doctrine until well into this century.¹⁶⁴

Before *Hart*, New York legislation provided favorable treatment to charitable donations, even to those that might not have conformed to statutory

156. *Id.* at 19–20. By contrast, a Connecticut act passed after the Revolution confirmed all estates granted for the support of religion, education, poor relief, "or for any other public and charitable use," as stated by the donor. *Id.* at 17.

157. 17 U.S. (1 Wheat.) 1 (1819).

158. *Id.* at 38–39. *But see* *Vidal v. Girard's Ex'r*, 43 U.S. (2 How.) 127 (1844) (effectively repealing *Hart* after the discovery of evidence that charitable trusts existed at common law, that is, without regard to English statutes).

159. MILLER, *supra* note 114, at 43 & n.10.

160. Note 1: On Charitable Bequests, 17 U.S. (4 Wheat.) app. at 23 (1819). This volume also contains *Trustees of Dartmouth College v. Woodward*, 17 U.S. (4 Wheat.) 518 (1819), holding the charter of a charitable corporation inviolate from state alteration under the Contracts Clause of the Constitution.

161. *Gallego's Ex'rs v. Attorney Gen.*, 30 Va. (3 Leigh) 450 (1832).

162. *Id.* at 479.

163. *Id.* at 480. In 1836, Tucker, a follower of the Enlightenment, told his law students that the clergy hover around the deathbed "like vultures and vampires, to defraud the unhappy heir." MILLER, *supra* note 114, at 44. Tucker wrote in *Gallego's Executors*, "[w]ealth is power," and in Virginia wealth primarily meant land. *Id.*

164. MILLER, *supra* note 114, at 47.

requirements.¹⁶⁵ But in 1829 the New York Legislature adopted a mortmain prohibition modeled on the English law, under which a corporation could accept only such devise as authorized by its charter or by statute. "Strictly interpreted," observes Miller, "the statute virtually abolished trusts in the state of New York."¹⁶⁶ The legislature subsequently permitted corporate charities to take both realty and personalty by devise, putting monetary limits on the value and income (and the percentage of the decedent's estate).¹⁶⁷

But the existence of statutory limits on corporate charities led the New York courts to strike devises in trust for charitable purposes.¹⁶⁸ To historian Stanley Katz, charitable trusts "were innocent bystanders, killed off partly because of their peculiar place in a peculiar court, and partly because the liberalization of corporation law circumscribed the social costs which might be incurred through their demise."¹⁶⁹ For example, in the 1965 case of *Levy v. Levy*,¹⁷⁰ the owner of Thomas Jefferson's estate at Monticello endeavored to devise the property in trust for educating the orphans of naval officers to be farmers. The New York Court of Appeals invalidated the charitable bequest, declaring: "who shall say what is useful learning, what is benevolence, and what is charity, unless it be the legislature?"¹⁷¹ Finally, the failure of Samuel J. Tilden's multimillion dollar bequest to fund a free public library in New York City caught the attention of the public, and prompted speedy legislative reform.¹⁷²

Today, most state statutes still provide explicitly that charities can acquire

165. *Id.* at 18.

166. *Id.* at 19. Quickly following suit, the Pennsylvania "legislative committee on corporations refused either to renew or to grant charters to missionary societies, church congregations, library companies, and charity schools and hospitals." *Id.*

167. Stanley N. Katz et al., *Legal Change and Legal Autonomy: Charitable Trusts in New York, 1777-1893*, 3 L. & HIST. REV. 51, 70-72, 81-82 (1985). A substantial devise to Cornell University failed because the university's assets had just reached their charter limit of \$3 million in value. *In re McGraw's Estate*, 19 N.E. 233 (N.Y. 1888), *aff'd sub nom.* Cornell Univ. v. Fiske, 136 U.S. 152 (1890).

168. Katz et al., *supra* note 167, at 72-87.

169. *Id.* at 80.

170. 33 N.Y. 97 (1865).

171. *Id.* at 115. Describing the perceived will of the legislature to confine "the accumulation of property perpetually appropriated, even to charitable and religious objects," *id.* at 111, the court found "that such property should not be withdrawn from circulation, and the general uses of society, for promoting objects, public in their nature, unsanctioned by the legislative power, and which may be in themselves the offspring of the grossest ignorance, caprice and folly." *Id.* at 114-15.

172. See *Tilden v. Greene*, 28 N.E. 880 (N.Y. 1891). The Tilden Act, 1893 N.Y. Laws 701 (the predecessor to EPTL 8-1.1), provided that gifts for charitable uses could not be "deemed invalid by reason of the indefiniteness or uncertainty of" their beneficiaries. See FREMONT-SMITH, *supra* note 14, at 39. To Katz, "it was easy to restore the possibility of private direction to charity law because it had never really been replaced by any more meaningful public control than that which was ordinarily available in equity." Katz et al., *supra* note 167, at 88.

and hold real and personal property.¹⁷³ Other states impose a general restriction limiting the charity to only such property as is necessary to carry out its charitable purposes. A few states specify acreage limits. Others limit the dollar value of land or personalty, or both, for certain types of charities,¹⁷⁴ or the income that can be earned on property. In a few states, land cannot be devised (as opposed to gifted *inter vivos*) to a corporate charity.¹⁷⁵ In general, many of the limitations enacted in the nineteenth century have been repealed or liberalized.¹⁷⁶

B. Henry VIII Seizes Monastic Property

English kings dissolved monasteries in centuries past,¹⁷⁷ and so when Henry VIII increased his demands for funds, the church's vast wealth once more attracted attention. The newly emerging middle class

listened with avidity to proposals for a more beneficial distribution of the church's property. They began to figure on shifting the burden of taxation from their shoulders by a new appropriation of ecclesiastic endowments. Finally, they began to develop itching palms for the wealth of the clergy to improve their own private fortunes.¹⁷⁸

Who was to defend the monasteries? A nineteenth-century apologist maintained:

The monasteries built for posterity. The never dying nature of their institutions set aside in all their undertakings every calculation as to time and age. Whether they built or planted, they set the generous example of providing for the pleasure and honour of generations unborn. They executed everything in the very best manner: their

173. For citations to the statements in this paragraph, see FISCH ET AL., *supra* note 20, § 469 (charitable corporations), § 470 (unincorporated charities).

174. See, e.g., IND. CODE ANN. § 23-13-15-1 (West 1994) (incorporated university or college may not own more than \$500,000 of real estate, exclusive of the realty used and occupied for school grounds and buildings, and all such real estate must be disposed of within 20 years).

175. FISCH ET AL., *supra* note 20, § 471; cf. *Osnes v. Morris*, 298 S.E.2d 803 (W. Va. 1982) (transfer of interest in land to an incorporated church void under state constitution; attempt to transfer the interest to trustees invalid, and land reverts to heirs of original grantor).

176. "Even though [remaining] statutory restrictions would appear to severely limit the capacity of corporations and associations to take property, they have met with little opposition perhaps because they can be rather easily circumvented by the incorporation of other organizations to hold property." FISCH ET AL., *supra* note 20, § 468; cf. I.R.C. § 501(c)(2) (1994) (extending federal income tax exemption to "[c]orporations organized for the exclusive purpose of holding title to property, collecting income therefrom, and turning over the entire amount thereof, less expenses, to an organization which itself is exempt under this section").

177. KENNY, *supra* note 15, at 193.

178. Oscar A. Marti, *Economic Factors Tending Toward Secularization of Church Property in England, 1533-39*, 37 J. POL. ECON. 451, 471 (1929).

gardens, fish-ponds, farms—in all, in the whole of their economy, they set an example tending to make the country beautiful, and to make it an object of pride with the people, and to make the nation truly and permanently great.¹⁷⁹

A twentieth-century American economist, however, painted a diametrically opposed picture:

The continuance of ecclesiastical institutions existing largely for non-producing monks and pilgrims, for the distribution of alms, and for an outworn feudal system of tenantry, was challenged by men who by thrift, frugality, and industry had made their way to a place of importance under the new economic régime. The church[’s]...splendid empty ceremonies, its broad waste places of ritual and devotion, its frequent holidays, were little suited to the new order of things.¹⁸⁰

In the 1530s, Henry VIII dissolved the monasteries, first small, then large. The crown seized the properties on the grounds of “bad discipline and general inefficiency,” based on an unfavorable report of visitors chosen by Henry’s minister, Thomas Cromwell.¹⁸¹ This motive, however, was pretextual. The monasteries “had broad lands, compliant heads, hostile critics in the parliamentary classes and among the secular clergy. They did not enjoy anything like that measure of popular esteem which modern romantics have thought to observe. Certainly they were not dissolved because of any dangerous devotion to the Papacy....”¹⁸² Most of the deracinated monks received pensions, or simply departed, many having “merged without regret into lay life.”¹⁸³

What happened to the provision of social services for the poor?¹⁸⁴

179. FINLASON, *supra* note 131, at 38–39 n.‡ (quoting Cobbett, *History of Reformation*).

180. Marti, *supra* note 178, at 470–71. But routines were upset:

The minister who stressed Bible-reading to a largely illiterate congregation, who denigrated the cycle of fast and feast linked to the harvest year, who replaced active ritual with tedious sermons to pew-bound parishioners, and who refused to supply protective magic for this world and the next, was naturally less popular than his priestly predecessor.

Christopher Haigh, *Anticlericism and the English Reformation*, in *THE ENGLISH REFORMATION REVISED* 56, 73 (Christopher Haigh ed., 1987).

181. A.G. DICKENS, *THE ENGLISH REFORMATION* 141 (1964).

182. *Id.* at 139. The Lutheran rulers of Germany and Scandinavia were engaged in a similar policy of dissolution. *Id.* at 141.

183. *Id.* at 143. Barred for a period from marrying, those former monks (and nuns) who did so under King Edward VI found themselves divorced a few years later by the Catholic Queen Mary. *Id.* at 145.

184. See B. KIRKMAN GRAY, *A HISTORY OF ENGLISH PHILANTHROPY* 11 (1905) (“It is true that those who received grants of the confiscated monastic property were required by the Act to provide the accustomed hospitality and service for the poor; but in most cases this duty was evaded wholly or in part.”).

Evidence is mixed, but it appears that the poor were not much worse off simply because the monasteries had not much provided for them. Recent scholastic fashion has perhaps overreacted against a romanticized medievalism: "Nowadays, indeed, it is sometimes said that the final dissolution of the monasteries aggravated the problems of poverty in sixteenth century England only by throwing a crowd of monastic servants and hangers-on onto the labor market, not by cutting off a major source of relief to the needy."¹⁸⁵ Studies of monastic spending for charity range from 3% to 5% to 10.8%, but all of these are estimates.¹⁸⁶ Most important:

[The] monastery, after all, was not an eleemosynary institution. The first business of the monks was to carry on from day to day the routine of corporate liturgical worship laid down in their rule. According to medieval ideas, the men who dedicated their lives to this supremely worthy task ought themselves to be supported in a decent and dignified fashion; it was also considered fitting that the worship of God should be carried on in magnificent buildings, and that incense, rich cloths, and precious metals should be used in religious ritual.¹⁸⁷

Taking Wilbur K. Jordan's figures on private philanthropy¹⁸⁸ and adjusting them for inflation and for the yield from prior endowments, J.F. Hadwin concludes: "In money terms the deficiency [from the loss of monastic poor relief]...was made good by the 1560's and in real terms by at least the 1580's."¹⁸⁹

The crown needed a system to deal with its newly seized assets. Henry's minister, Thomas Cromwell, created a Court of Augmentations "to manage ex-monastic lands and administer their revenues."¹⁹⁰ The net income of these

185. TIERNEY, *supra* note 95, at 80. Recent scholarship disputes a "catastrophic" view of the dissolution, which "told of monks and nuns reduced to beggary, up to 80,000 monastic dependents deprived of their daily bread, the 'proverbially liberal' abbots replaced by lay landlords, who rack-rented their poor tenants, enclosed for pasture, drove men off the land and destroyed villages and rights of common." DICKENS, *supra* note 181, at 151. The rural depopulation caused by the enclosure of farmland for sheep grazing and the problem of urban poverty antedated the dissolution by over half a century, while "the lands and economic interests of the monasteries were overwhelmingly rural." *Id.* at 152; *see also id.* at 154. Finally, the increases in rents cannot be evaluated separately from the increases in prices, which doubled between 1540 and 1560 and continued to rise; and so any "landlord who failed to raise his rents and entry-fines would have been a fool or a saint." *Id.*

186. TIERNEY, *supra* note 95, at 80-81 & n.27.

187. *Id.* at 81.

188. *See* JORDAN, *supra* note 14.

189. J.F. Hadwin, *Deflating Philanthropy*, 31 *ECON. HIST. REV.* (2d ser.) 105, 113 (1978). Hadwin concludes that private philanthropy never amounted to more than 0.5% (for total secular benefactions) and 0.25% (for just poor relief) of current national income: "In view of the social needs of the times, even after the early seventeenth-century 'explosion of giving,' what must have been more audible was not the bang but the whimper." *Id.* at 117. The first attempt to deflate Jordan's numbers was made by William G. Bittle & R. Todd Lane, *Inflation and Philanthropy in England: A Re-Assessment of W.K. Jordan's Data*, 29 *ECON. HIST. REV.* (2d ser.) 203 (1976).

190. DICKENS, *supra* note 181, at 144.

properties "represents considerably more than three times the income of all the Crown estates on the eve of the Dissolution."¹⁹¹ Rather than preserving these properties (as Cromwell planned) for a "huge and permanent non-parliamentary" endowment,¹⁹² Henry sold off seized estates in order to finance his wars.¹⁹³ (However, by requiring that the sold-off property be held "by knight-service to the Crown," Henry enjoyed continuing feudal incidents from the holders.)¹⁹⁴ The crown's continued desperation for revenue expressed itself in additional sales of monastic properties throughout the Tudor reign.¹⁹⁵ One historian makes sure to point out: "From first to last, the acquisition of monastic lands suggested itself to men of all opinions in terms of strict business. The compunction, the sentiment, the nice scruples, the superstition that an evil destiny awaited the buyers, these were invented by later and more poetic generations."¹⁹⁶

Henry's intent to preserve monastic properties for educational and other charitable purposes went largely by the boards.¹⁹⁷ Worse, the universities suffered a

191. *Id.* at 147. About one-fourth of the wealth came from ecclesiastical incomes, with the rest comprising investment real estate. *Id.* at 147-48 ("About a quarter of the gross income arose from tithes, glebes and other proceeds of benefices appropriated to the monasteries; the rest was ordinary temporal income, chiefly from rural estates.... In addition to this immense income the Crown acquired a very large lump sum from the sale of bullion, plate and other valuables."). Professor Dickens describes with regret the melting down of reliquaries, images "and other splendid examples of medieval metal-work and jewelry" at "a moment when the need of the government for cash had become so insatiable, when public museums did not exist, when disinterested connoisseurship and antiquarianism had not passed their raw infancy in England." *Id.* at 148. While many books and manuscripts were lost, many were preserved by Henry himself in what is now the Royal collection in the British Museum, *id.* at 148-49, and by Sir Thomas Bodley in what is now the Bodlian Library at Oxford. A.L. ROWSE, *THE ENGLAND OF ELIZABETH: THE STRUCTURE OF SOCIETY* 514-15 (1951).

192. DICKENS, *supra* note 181, at 150.

193. Ironically, the success of Catholic explorers in the New World in discovering silver deposits caused rampant inflation back home, boosting, among other things, England's costs of ships and cannon. *See id.* at 140. At the same time, Henry VIII's divorce and the resulting schism increased the risk of a Papal invasion, or of an invasion by a country sympathetic to the Pope. *Id.* The war of 1542-1546 against Scotland and France cost £2 million, which required Henry to sell nonmonastic holdings as well. *Id.* at 155.

194. Reid, *supra* note 117, at 238 (quoting JOEL HURSTFIELD, *THE QUEEN'S WARDS: WARDSHIP AND MARRIAGE UNDER ELIZABETH I*, at 10 (1958)).

195. R.B. Outhwaite, *The Price of Crown Land at the Turn of the Sixteenth Century*, 20 *ECON. HIST. REV.* (2d ser.) 229, 239 (1967). *See generally* H.J. Habakkuk, *The Market for Monastic Property, 1539-1603*, 10 *ECON. HIST. REV.* (2d ser.) 362 (1958).

196. DICKENS, *supra* note 181, at 160. By this time, moreover, tithes had become commodified, and a sound investment. "In the popular mind tithe was hence already assimilated to temporal revenue and no outcry of sacrilege arose when it was bought by the 'new monastics' of the squirearchy." *Id.* at 164.

197. Cambridge University, for example, requested one of the dissolved monasteries, praying "that by turning the houses dedicate[d] to vain religion into colleges of true and sincere doctrine, learning and virtue should greatly be augmented." MARIA DOWLING, *HUMANISM IN THE AGE OF HENRY VIII*, at 102 (1986) (quoting 1538 letter from

fresh scare in 1545, when Parliament passed the deceptively narrow-sounding Chantries Act,¹⁹⁸ authorizing the suppression of all colleges and the escheat of their possessions to the crown.¹⁹⁹ When commissioners were appointed to survey the university colleges in 1546, Oxford and Cambridge "hastened to throw themselves on the King's mercy."²⁰⁰ A sympathetic Henry founded Trinity College at Cambridge from surrendered property there plus a large grant from the Court of Augmentations, and similarly founded Christ Church at Oxford, "for the education of the clergy in the new learning."²⁰¹

The closest American analogue to the seizure of the monasteries occurred when the Mormon Church sanctioned polygamy, thereby forfeiting its charter. The Supreme Court approved a *cy pres* proceeding for transferring the property to another charitable purpose.²⁰²

Cambridge University to Thomas Cromwell). Various additional pensions and endowments were transferred to colleges and universities on an ad hoc basis. Henry's most significant use of monastic wealth for education took the form of endowments for ten Regius scholars, five at Oxford and five at Cambridge. *Id.* at 104.

198. A chantry was an endowment for saying masses and prayers for the donor's soul, or a chapel for that purpose. Shakespeare has Henry V, in prebattle prayer, invoke his expiations for his father's usurpation of Richard II's crown:

Five hundred poor I have in yearly pay,
Who twice a day their withered hands hold up
Toward heaven to pardon blood;
And I have built two chantries,
Where the sad and solemn priests sing still
For Richard's soul.

WILLIAM SHAKESPEARE, HENRY V, act 4, sc. 1. By the late Middle Ages, the cathedrals had become "an accumulation of chapels and altars under one roof for the endless round of soul-masses for lay and ecclesiastical benefactors"—Durham numbered in the tens of thousands. PAUL JOHNSON, A HISTORY OF CHRISTIANITY 227 (1976). The will of Henry VIII himself called for "daily Masses perpetual so long as the world endured" for the repose of his soul. KEETON, *supra* note 17, at 46.

199. In 1532, Henry VIII had tried to dissuade donations of land to chantries, by providing that all feoffments, except those for less than 20 years, "to the uses and intentes to have obittes perpetuall, or a continuall service of a Priste for ever" would escheat to the mesne lord. 23 Hen. 8, ch. 10 (1532) (Eng.). In 1545, claiming maladministration, the crown seized chantry property for itself. 37 Hen. 8, ch. 4 (1545) (Eng.). After Henry died in 1547, Edward VI immediately revived the statute. 1 Edw. 6, ch. 14 (1547) (Eng.). Edward, however, justified seizure to suppress "superstitious" errors in religious practices due to "devising and phantasysinge vayne opynions of Purgatorye and Masses satisfactorye to be done for them which be departed." *Id.* The preamble, further, promised "converting to good and godlie uses, as in erecting of Gramer Scoles to the educacion of Youthe in vertewe and godlinesse, the further augmenting of the Universities and better provision for the poore and nedye." *Id.*

200. DOWLING, *supra* note 197, at 105.

201. *Id.* at 106.

202. Late Corp. of the Church of Jesus Christ of the Latter-Day Saints v. United States, 136 U.S. 1, 63-65 (1890), *modified*, 140 U.S. 665 (1891) (upholding the Edmunds-Tucker Act of 1887, ch. 397, 24 Stat. 635); *see* Society of Separationists v. Whitehead, 870 P.2d 916, 921-29 (Utah 1993) (describing history of Utah statehood).

In Mexico, the sixteenth-century Spanish conquest brought Catholic missionaries.²⁰³ Over the centuries, "[t]he greater became the Church holdings, and they were usually of the best land in a given community, the less land was left for the laity to own, and the fewer were the chances that the very small incipient middle class would get a foothold."²⁰⁴ During the war with the United States in the 1840s, Mexicans "looked with longing eyes at that wealthiest of all institutions of the country, the Church."²⁰⁵ By the 1850s, "the Catholic Church owned half the land in Mexico and actively opposed its independence from Spain."²⁰⁶ To break its power, President Benito Juárez "stripped the church of its property, except for church buildings, closed monasteries and convents, nationalized cemeteries and made marriage a strictly civil act."²⁰⁷ Having regained some of its power, the church backed the rich in the revolution of 1910.²⁰⁸ Provisions of the Mexican Constitution of 1917 nationalizing church property, banning parochial schools, and limiting the political and property rights of clerics were finally enforced in 1926, prompting the church to close its doors to provoke a popular rebellion.²⁰⁹ Beginning in the 1940s, however, state and church reached an informal accommodation, and "the church...managed to acquire property by setting up private corporations."²¹⁰ Finally, in 1992, the constitution was amended to permit church ownership of property and restore the clerics' civil rights.²¹¹ However, the

203. See WILFRID HARDY CALLCOTT, *CHURCH AND STATE IN MEXICO, 1822-1857*, at 7-8 (1926) (emphasizing that "Spanish colonization was based upon 'gospel, glory and gold'").

204. *Id.* at 14.

205. *Id.* at 161-162.

206. Marjorie Miller, *Mexico's Church-State Ties Step Out from the Shadows*, L.A. TIMES, Apr. 29, 1990, at A1. Cf. FRANK BRANDENBURG, *THE MAKING OF MODERN MEXICO* 188 (1964) ("When Juárez and his cohorts lashed out at Catholicism in the 1850's, the Church probably still owned one-third of the entire land in Mexico.").

207. Miller, *supra* note 206, at A1. For history and details, see CALLCOTT, *supra* note 203, at 248-57, in which the 1856 law requiring the Church to sell its lands held for investment is discussed. See also *id.* at 283, 289 (discussing Article 27 of the Constitution, prohibiting any civil or ecclesiastical corporation from owning real estate); *id.* at 319-21 (discussing confiscation of property of clergy, the transfer of marriage ceremonies and registration of births and death to civil authorities, and the nationalization of cemeteries).

208. Miller, *supra* note 206, at A1.

209. *Id.* "The army burned churches, hanged priests, shot [the religious rebels] or locked them in concentration camps." *Id.* See also LARSON & LOWELL, *supra* note 70, at 24 ("by 1926, the Church was reputed to have owned two-thirds of the real estate in Mexico City, all tax-free, and most of it obtained by rituals promising to effect a prompt release of souls from purgatory").

210. Miller, *supra* note 206, at A1.

211. MEX. CONST., arts. 27, 130 (Jan. 1992). The amendment applies only to newly acquired property; the state will continue to own existing Mexican churches, temples, and synagogues. Tim Golden, *Mexico Ending Church Restraints After 70 Years of Official Hostility*, N.Y. TIMES, Dec. 20, 1991, at A1. Initially, in introducing this reform, President Carlos Salinas de Gortari had asserted, "[o]wing to past experience, the Mexican people do not want the clergy to take part in politics or to accumulate material wealth." Edward Cody, *Mexico to Grant Catholic Church Legal Status; Long Ignored, Constitutional Limits*

amendment specifically prohibits both a cleric (and his relatives), as well as the religious association to which he belongs, from inheriting property, if the cleric had ministered to the decedent (and is not closely related to the decedent).²¹² Moreover, implementing legislation "restricts the rights of churches to own businesses and communications media."²¹³

C. The Eighteenth-Century Democratization of Charity

The eighteenth century brought a sea change in philanthropic organization. New charities were founded by "organizers, not givers," and financed by voluntary subscription.²¹⁴ "One notable tendency was the rejection of the traditional model of the benevolent man as a wealthy individual who left a great fortune to the perpetuation of his own name and the erection of an institutional charity."²¹⁵ While methods differ somewhat, today's charity will see the roots of its grinding, never-ending quest for funds in the "associated charity" practices of the eighteenth century. "Benefits at theaters and operas, charity sermons and dinners, and contributions following stirring exhortations or choral works in the chapels often attached to the charities were just some of the methods."²¹⁶

The innovation of subscriptions changed more than financing. More akin to our joint-stock companies than to the federated United Ways, subscribers of specified minimums received privileges, not all of which are (at least explicitly) recognized by today's charities. First, subscribers could vote for the governors and readily approve changes in the charity's rules, an advantage over chartered charities.²¹⁷ Subscribers could also recommend staff.²¹⁸ Finally, they could recommend charity recipients, such as patients to be admitted to the hospital; upper-class subscribers used this privilege to place their superannuated servants.²¹⁹

Formally to Be Lifted, Though Some Will Remain, WASH. POST, Nov. 2, 1991, at A20.

212. "Los ministros de cultos, sus ascendientes, descendientes, hermanos y conyuges, asi como las asociaciones religiosas a que aquellos pertenezcan, seran incapaces para heredar por testamento, de las personas a quienes los propios ministros hayan dirigido o auxiliado espiritualmente y no tengan parentesco dentro del cuarto grado." MEX. CONST. art. 130 (Jan. 1992). I am grateful to Rafael Gely for translating this language for me.

213. United States Dept. of State, *MEXICO: Human Rights Practices*, 1992, DEPT. OF STATE DISPATCH, Mar. 1993, available in LEXIS, News Library, Arcnws File.

214. LANGFORD, *supra* note 93, at 491.

215. *Id.*

216. DONNA T. ANDREW, *PHILANTHROPY AND POLICE: LONDON CHARITY IN THE EIGHTEENTH CENTURY* 80 (1989). "Even composers as famous and widely patronized as Handel welcomed such occasions for benevolence combined with publicity...." *Id.*

217. LANGFORD, *supra* note 93, at 498.

218. ANDREW, *supra* note 216, at 86: "Some clearly gave to secure for themselves or their friends valuable positions as charity officer, either administrative (matrons, clerks, secretaries), medical (doctors, surgeons, apothecaries, druggists), religious (preachers), or supply (food, drink, coal, clothes)."

219. See, e.g., LANGFORD, *supra*, note 93, at 498 ("a useful perk in a household where a sick servant was certainly a liability and perhaps a source of infection"). Langford described the patronage system: "[Charities] kept elaborate records and devised complicated procedures to ensure that subscribers got what they paid for and no more. Hospitals could

Significantly, David Owen's study of English philanthropy found that the "existence of responsible voluntary institutions appealing regularly for support led to alterations in the habits of testators—how generally it is hazardous to guess."²²⁰ He continues:

Certainly perpetual trusts did not figure as heavily in charitable bequests as had been the case, on Jordan's evidence, in the earlier period. Benefactors, more often than not, left legacies with no strings attached to agencies which, suffering from the penury native to the charity world, tended to regard them as current income.²²¹

However, just when it appears that a rational age had abandoned perpetual endowments for rational reasons, it turns out that Owen was concerned only with properly measuring the amount added to charitable resources. He concludes:

Such benefactions were not added in official charitable endowments of the country and therefore found no place in official charity inventories.... Save for legacies to the more famous institutions, with their annual reports and other published material, they have dropped out of the historical record and for practical purposes are irrecoverable.²²²

Was it true that professional management, and regular outside sources of income, inspired donors to abandon perpetuity restrictions? If this is so, Owen leaves us to guess when, why, and to what extent donors later reverted to a desire for income-only restrictions.

Indeed, despite the democratization of funding,²²³ the fondness of donors for perpetuities never entirely ceased. The multiyear, multivolume reports of the Victorian Brougham Commissioners found a rather conservative range of interests expressed in endowed trusts set up in the eighteenth century.²²⁴ As summarized by Owen, half of the trusts provided doles or other benefits for the poor; next in popularity were educational trusts, and, in some cities, religious and almshouse

hardly penalize a patient once admitted, on account of his patron's misdeeds, but schools were quite capable of expelling pupils whose original proposer had stopped subscribing." *Id.* at 499 (citation omitted).

220. DAVID OWEN, *ENGLISH PHILANTHROPY, 1660-1960*, at 72 (1964) (footnote to Jordan omitted).

221. *Id.*

222. *Id.*

223. "Occasional legacies and larger benefactions apart...[t]ypically a school needed some tens of subscribers, and a hospital some hundreds, drawn from a wide range of occupations and embracing men and women of small property." LANGFORD, *supra* note 93, at 494.

224. The Brougham Commission, authorized by Parliament in 1818, issued 32 reports, the final one appearing in six parts between 1837 to 1840. An Analytical Digest appears in the *Parliamentary Papers* for 1843, XVI-XVII. See OWEN, *supra* note 220, at 192. Of the 28,880 charities listed, nearly half had an endowment yielding annual income of less than £5, and only 1749 produced annual income of more than £100. See *id.* at 193 & n.49 (setting forth figures from the *R.C. for Inquiring into Cases Reported but not Certified [1849]*, 1st Rep., 1850, at 3).

foundations. "Beyond these objects there was a scattering of benefactions for miscellaneous purposes, such as apprenticeship fees, loans to tradesmen, marriage portions, or land for general public purposes. Up to the end of the eighteenth century, medical charities figure occasionally, but their legacies were likely to come without trust provisions."²²⁵

The perpetual charity fund did attract critics. In the 1727 third voyage of Gulliver, Jonathan Swift wrote pityingly of the "Struldbrugg," a race of immortals occasionally born into mortal families on the island of Luggnagg. Victorian charity reformer Courtney Kenny suggested that Swift intended his Immortals of Luggnagg to be a metaphor for perpetual foundations.²²⁶ The Struldbruggs "commonly acted like Mortals, till about Thirty Years old, after which by Degrees they grew melancholy and dejected, increasing in both till they came to Fourscore."²²⁷ Thereafter,

[T]hey had not only all the Follies and Infirmities of other old Men, but many more which arose from the dreadful Prospect of never dying. They were not only opinionative, peevish, covetous, morose, vain, talkative; but incapable of Friendship, and dead to all natural Affection, which never descended below their Grand-Children.²²⁸

To deal with their Immortals, the Luggnaggs adopted special laws:

As soon as they have compleated the Term of Eighty Years, they are looked on as dead in Law; their Heirs immediately succeed to their Estates, only a small Pittance is reserved for their Support; and the poor ones are maintained at the publick Charge. After that Period they are held incapable of any employment of Trust or Profit; they cannot purchase Lands, or take Leases....²²⁹

Social developments rendered aging Struldbruggs irrelevant:

The Language of this Country being always upon the Flux, the *Struldbruggs* of one Age do not understand those of another; neither are they able after two Hundred Years to hold any Conversation (farther than by a few general Words) with their Neighbours the Mortals; and thus they lye under the Disadvantage of living like Foreigners in their own Country.²³⁰

Concluded Gulliver, after departing the island:

225. OWEN, *supra* note 220, at 75.

226. KENNY, *supra* note 15, at 160 (Swift describes the most recent Struldbrugg as having been "born about three years ago"; in 1724, Thomas Guy's mammoth bequest to found Guy's Hospital shocked the public, and contributed to the passage, in 1736, of the new law against mortmain.).

227. JONATHAN SWIFT, GULLIVER'S TRAVELS 236-37 (Heritage Press 1940).

228. *Id.* at 237.

229. *Id.* at 238.

230. *Id.*

I could not but agree, that the Laws of this Kingdom relating to the *Struldbruggs*, were founded upon the strongest Reasons, and such as any other Country would be under the Necessity of enacting in the like Circumstances. Otherwise, as Avarice is the necessary Consequent of old Age, those Immortals would in time become Proprietors of the whole Nation, and engross the Civil Power; which, for want of Abilities to manage, must end in the Ruin of the Publick.²³¹

In 1736, a decade after Swift published this work, George II's Parliament gave England the "modern law of mortmain," discussed above.²³²

The Victorian era produced a decades-long debate in Parliament and in society over the value and possible reform of endowed charities. Thoughtful contributions came from John Stuart Mill,²³³ Sir Arthur Hobhouse,²³⁴ Thomas Hare,²³⁵ and Courtney Kenny. Kenny's prize-winning 1880 essay began by

231. *Id.* at 240.

232. *See supra* notes 136–50 and accompanying text.

233. *See, e.g.,* Mill, *supra* note 38, at 4:

The sacredness of the founder's assignment should continue during his own life, and for such longer period as the foresight of a prudent man may be presumed to reach, and no further. . . . All beyond this is to make the dead judges of the exigencies of the living; to erect, not merely the ends, but the means, not merely the speculative opinions, but the practical expedients, of a gone-by age, into an irrevocable law for the present.

Mill, however, would apply a *cy pres* approach; that is, in altering the use of an endowment, the legislature should "depart as little from the original purpose of the foundation" as is necessary to employ it usefully. *Id.* at 15. Mill denied that such reform would violate the donor's intent:

Respect for the intention of the founder is not shown by a literal adherence to his mere words, but by an honest attempt to give execution to his real wishes; not sticking superstitiously to the means which he hit upon accidentally, or because he knew no better; but regarding solely, as he himself did, the end which he sought to compass by those means.

Id. at 22–23. Mill had no objection to perpetual charities *per se*—indeed, he would provide that "the new purpose to which [reformed endowments] may be diverted shall be of a permanent character, to remove the temptation of [the government's] laying hands on such funds for current expenses in times of financial difficulty." John Stuart Mill, *Endowments*, 5 *FORTNIGHTLY REV.* (n.s.) 377, 380 (1869).

234. *See, e.g.,* ARTHUR HOBHOUSE, *THE DEAD HAND: ADDRESSES ON THE SUBJECT OF ENDOWMENTS AND SETTLEMENTS OF PROPERTY* (1880). In the 1869 essay "On the Disposition of Property to Public Uses," Hobhouse asserted that the "failure" of endowments "is directly traceable to Founder-worship, to our slavish and literal adherence to the directions of Founders, instead of operating on the funds by public authority, and adjusting them from time to time, as change of circumstance requires." *Id.* at 118. A former Charity Commissioner, Hobhouse urged the creation of a "public tribunal, charged with the duty of adjusting to new objects all Foundations which have become pernicious or useless." *Id.* at 121 ("Local interests and feelings must be carefully ascertained and consulted, and occasionally even efficiency postponed for the sake of conciliation").

235. *See, e.g.,* Thomas Hare, *Charitable Endowments, in Their Relation to the*

observing that perpetuity creates the paradox "that whilst charity tends to do good, perpetual Charities tend to do evil. Too often, misdirected by their Founder or misconducted by their administrators, they bless neither him that gives nor him that takes."²³⁶ Kenny lamented "the inevitable tendency of endowed charities to be either neglected or perverted as time runs on. Hence it is utterly inexpedient to narrow their resources during their youth, for the purpose of augmenting their superfluities in their decrepitude."²³⁷

Kenny dubbed this characteristic of entropy and decline the "Principle of Caducity."²³⁸ He would respect a founder's charitable scheme only for a limited period,²³⁹ endorsing a "Term of Inviolability" during which the founder's desires, both to principles and details, would be respected. (Various Victorian reformers proposed terms of twenty-one years, thirty years, fifty years, sixty years, and one-hundred years, as well as the founder's life plus twenty-one years.)²⁴⁰ Kenny believed that "no Founder whose Foundation was worth having, would be discouraged by this prospect from creating it."²⁴¹ Indeed, he asserted: "Experience of the evil results of strictly adhering to a Founder's obsolete intentions has discouraged many men of benevolence from creating new Foundations."²⁴² Kenny would not leave reforming an obsolete trust to the initiative of the charity managers, but rather would permit a governmental board to revise and modernize trusts.²⁴³

Following the ravages of World War II, voluntary organizations in England suffered from the fact that "the gentry have now become the indigentry."²⁴⁴ Meanwhile, through a series of social welfare bills, the state took over many of the functions of private philanthropy, by providing old-age pensions, national health service, and unemployment assistance.²⁴⁵

State and to Public Taxation, 2 FORTNIGHTLY REV. (n.s.) 129, 131 (1867) ("[W]hatever unforeseen changes may occur, the Legislature having left the subject to the courts of law, the latter have adhered to the literal restriction of class and area, and where that has become impossible, instead of confessing the infirmity of its jurisdiction, have invested a fantastic doctrine called *cy prés*, to confine the application of the fund to the smallest class or locality which approaches the original description. The benefits of these endowments have thus been prevented from reaching the great body of the poor of the kingdom..."); Thomas Hare, *Estates of Endowments*, 7 FORTNIGHTLY REV. (n.s.) 309 (1870).

236. KENNY, *supra* note 15, at 3.

237. *Id.* at 89.

238. *Id.* at 11 (crediting Robert Lowe for the phrase).

239. *Id.* at 25.

240. *Id.* at 215.

241. *Id.* at 189.

242. *Id.* Kenny pointed to the recent will of Baron Rothschild, which directed his wife "to give £10,000 among Jewish charities, and £5000 among Christian charities, *the money not to be invested but to be spent for some immediate benefit or improvement.*" *Id.* (Kenny's emphasis).

243. *Id.* at 235 ("administrators are seldom willing to accept, much less to initiate, innovations upon their accustomed modes of working").

244. OWEN, *supra* note 220, at 575 (quoting Lord Samuel in a House of Lords debate on June 22, 1949).

245. *Id.* at 531-32.

D. American Philanthropy and the Dilemma of Private Foundations

In the United States, the private nonprofit sector has also performed an important economic and political function.²⁴⁶ Historian Peter Dobkin Hall found that the elitist nineteenth-century Boston Brahmins (fearful of the political power of the general populace),²⁴⁷ endowed universities, hospitals, and other charities in order to build up the learned professions (law, medicine, science, and business) in which their sons were trained. This new generation of professionals then became charity trustees, and managed the endowments by investing in local industrial and commercial enterprises.²⁴⁸ Dramatically illustrating the impact of such arrangements was the pattern of bank failures during the depression of 1837–1842. Of the twenty-four commercial banks in Boston that survived, twenty-one enjoyed interlocking directorships with charities, while nine of the ten failed banks lacked any such connection.²⁴⁹

A different model of philanthropy developed in the Midwest, one with closer ties between the public and private sectors. As the states created land-grant colleges and universities, Midwestern business took a more populist approach to linking the proprietary and nonprofit sector. Somewhat akin to England's "associated philanthropy" and subscription drives, Cleveland's business community conducted coordinated appeals (federated campaigns) permitting donor designation of a charitable beneficiary.²⁵⁰ In 1913, Cleveland pioneered the "community foundation," a mechanism that pools small donations and manages them for local charitable purposes in perpetuity.²⁵¹ The Cleveland Foundation was

246. Portions of this section appeared in substantially the same form in Evelyn Brody, *Institutional Dissonance in the Nonprofit Sector*, 41 VILL. L. REV. 433, 438–40, 475–77 (1996).

247. Defending Harvard's property-tax exemption before the legislature in 1874, president Charles Eliot asked:

Who have built up the manufactures and trade of this bleak and sterile Massachusetts? A few men of singular sagacity, integrity, courage, backed by hundreds of thousands of men and women of common intelligence, courage, and honesty.... Massachusetts today owes its mental and moral characteristics, and its wealth, to eight generations of people who have loved and cherished Church, School, and College.

PETER DOBKIN HALL, *INVENTING THE NONPROFIT SECTOR* 182 (1992).

248. *Id.* at 174.

249. *Id.* at 176.

250. *Id.* at 163. The United Way began in Denver in 1887, and the Cleveland Chamber of Commerce created the first Community Chest at the turn of the century. JOHN S. GLASER, *THE UNITED WAY SCANDAL* 36–37 (1994).

251. See Peter Dobkin Hall, *The Community Foundation in America, 1914–1987*, in *PHILANTHROPIC GIVING: STUDIES IN VARIETIES AND GOALS*, *supra* note 31, at 180. The community trust mechanism permits settlers of small trusts to pool their resources under the management of a committee; donors can impose conditions on the use of their funds while investing the trustees with the legal authority to make better use of the money, it being understood that trustees would not lightly deviate from donors' directions. For example, one community trust declaration states that it will "respect any wishes expressed in creating the gift;" but if it determines "that it is unwise or impractical to apply the gift, devise, or

essentially a quasi-public body; elected officials and judges dominated the board.²⁵²

Technological revolutions after the Civil War produced almost unimaginable concentrated private wealth, giving rise to the grant-making foundation, often family controlled. By the 1920s, these massive endowments "helped tie together the system of government bureaus, private social-service agencies, universities, trade associations, and professional societies that composed the backbone of Hoover's associationist vision."²⁵³

In May 1929, the *Atlantic Monthly* published an essay by Sears, Roebuck founder Julius Rosenwald that created a sensation in philanthropic circles. It opposed "gifts in perpetuity for any purpose." Rosenwald began his article with a description that, except for the amounts, could have been written today:

There are few colleges in the land today which are not striving for "adequate endowment." Museums, orchestras, operas, homes for the aged, hospitals, orphanages, and countless other charitable and remedial organizations, are aiming at the same goal. It was recently estimated that more than two and a half billion dollars were given to various endowments in this country in the last fifteen years. The sum is vast, equal to the total national wealth a hundred years ago, but institutions continue to solicit more and greater endowments, and men of wealth are encouraging them with ever-increasing gifts.

"All of this giving and receiving," Rosenwald lamented, "is proceeding without much, if any, attention to the underlying question whether perpetual endowments are desirable."²⁵⁴

Detesting the notion of the perpetual charity, Rosenwald delighted in collecting stories of restrictive trusts gone horribly wrong. He mandated that the Rosenwald Foundation terminate after twenty-five years, as indeed it did in 1946, fourteen years after his death.²⁵⁵ In its lifetime, the Rosenwald Foundation built

bequest to the purpose or in the manner indicated by the donor, or to expend income only" it will spend as "will best comply with the purposes of this trust, and will be most nearly related to the purpose indicated by the donor." Resolution and Declaration of Trust of the Mount Vernon [Ohio] Community Trust art. II.B, 1946, in *LEGAL INSTRUMENTS OF FOUNDATIONS*, *supra* note 18, at 141, 143.

252. HALL, *supra* note 247, at 164.

253. *Id.* at 187. See generally WALDEMAR A. NIELSEN, *THE BIG FOUNDATIONS* (1972).

254. Julius Rosenwald, *Principles of Public Giving*, *ATLANTIC MONTHLY*, May 1929, reprinted in *AMERICA'S VOLUNTARY SPIRIT* 119, 119 (Brian O'Connell ed., 1983) [hereinafter Rosenwald, *Principles*]; see also Julius Rosenwald, *The Trend Away from Perpetuities*, *ATLANTIC MONTHLY*, Dec. 1930, at 749.

255. Letter of Gift from Julius Rosenwald to the Julius Rosenwald Fund, in *LEGAL INSTRUMENTS OF FOUNDATIONS*, *supra* note 18, at 272. A few shared Rosenwald's principles. Baron de Hirsch's will preferred preserving capital, but permitted the trustees, by written two-thirds agreement, to spend from capital if necessary to "adequately" carry out the trust's purposes, but not for the first ten years, "and in such cases only for the purpose of the purchase of land and the erection of buildings for schools..., and not more than ten per

5,300 rural schools in the South, funded leading black colleges, improved services in seventeen hospitals (including the one affiliated with the University of Chicago) in return for their training black interns and doctors, and pressed for liberalizing segregation laws.²⁵⁶

Two general types of donor restrictions concerned Julius Rosenwald. The first were those given for a narrow purpose, which, inevitably, outlive the exigencies of their era.²⁵⁷ Second, Rosenwald wrote of the "endowment poor" institutions, and the resulting harm to society: "Research suffers; museums are unable to purchase objects that never again will be available; experiments of all sorts are frowned upon, not because they do not promise well, but because money to undertake anything out of the ordinary cannot be found, while huge sums are regularly budgeted to carry on traditional and routine activities."²⁵⁸ Against the argument that endowments tide organizations over hard times, he asserted that those "are precisely the times when it is most important to have unrestricted funds which will permit our institutions to continue their work until conditions improve, as they always do."²⁵⁹

Rosenwald blamed the timidity of the trustees themselves for their inability to spend principal. "Donors would in many cases be willing to give greater discretion to trustees in such matters if they were asked to do so."²⁶⁰ Indeed, in the course of working with charities, Rosenwald observed how "funds given with no strings attached have been added to the perpetual endowment as a matter of

cent of the capital shall be expended in any year." Deed of Trust of the Baron de Hirsch Fund, Jan. 22, 1891, arts. 8 & 9, in LEGAL INSTRUMENTS OF FOUNDATIONS, *supra* note 18, at 85, 89. The 1945 will of Emil Schwarzhaupt imposed a 25-year life on his foundation, and forbid paying Foundation funds into any endowment. Last Will and Testament of Emil Schwarzhaupt, signed Dec. 19, 1945, art. 11, in LEGAL INSTRUMENTS OF FOUNDATIONS, *supra* note 18, at 73, 77 ("in the long run society is benefitted by having each generation solve its own problems and provide the necessary funds for so doing, and...endowments, in order to be responsive to the ideals, wishes and needs of each respective generation, should be created by such generation").

256. See NIELSEN, *supra* note 253, at 337, 340-42; McCarthy, *supra* note 100, at 55. But see James D. Anderson, *Philanthropic Control Over Private Black Higher Education*, in PHILANTHROPY AND CULTURAL IMPERIALISM 168 (Robert F. Arnove ed., 1980) (Rosenwald and other industrial philanthropists "were primarily interested in supporting black institutions" committed to maintaining "a separate and subordinate Negro society").

257. Rosenwald describes the fund for pioneers passing through St. Louis; only a few years later the trustees could find no qualifying beneficiaries. Rosenwald eulogized the benefactor while condemning his folly:

He deserves to be remembered as a generous-hearted man who realized, perhaps better than anyone else in his generation, that a wealth of pioneer blood and energy was being dissipated in the creation of our American empire. If he is remembered at all, it is more likely as the creator of a perpetuity which lost its usefulness almost as soon as it was established.

Rosenwald, *Principles*, *supra* note 254, at 121.

258. *Id.* at 123.

259. *Id.* at 126.

260. *Id.* at 124.

course.²⁶¹ Rosenwald saves some of the blame for knee-jerk drafting by lawyers, who "have not learned that money can be given in any other way."²⁶² Rosenwald acknowledged the donor's desire for a lasting memorial—"an end which becomes increasingly attractive to many men with advancing years"—but reminds us that nothing endures.²⁶³ Indeed, perpetuities express a lack of confidence in trustees, who "are told that they are wise enough and honest enough to invest the money and spend the income amounting to 4 to 5 percent each year; but they are told in the same breath that they are not capable of spending 6 to 10 or 15 percent wisely."²⁶⁴ Perhaps worse, perpetuities encourage the build-up of bureaucracies²⁶⁵—of course, this sinecure might explain why trustees put up with the insult of limited confidence.

Foundations most clearly raise the issue of the propriety of perpetual endowments. Narrowly endowed foundations suffered several bruising series of Congressional attacks during the twentieth century. This subset of charity was officially dubbed the "private foundations" by the Tax Reform Act of 1969. Private foundations attract so much attention because they typically consist of a fund of investment assets, were initially funded by a single donor, are managed by that donor or his or her family or close associates, and exist commonly to make grants to other charities rather than to conduct charitable activities directly.

In the 1912 presidential race, Theodore Roosevelt opposed federal charters for foundations, because "no amount of charity in spending such fortunes [as John D. Rockefeller's] can compensate in any way for the misconduct in acquiring them."²⁶⁶ In its 1916 final report, Congress' Commission on Industrial Relations "charged that the concentration of wealth in the large foundations, such as the Carnegie and the Rockefeller, was being used by industrial magnates to gain control of the universities and, thereby, the social and educational side of American life."²⁶⁷ The report recommended "requiring federal charters for the incorporation of all nonprofit organizations with more than one function and funds of more than \$1 million, limitation on size, income, and life of the foundations, and the creation of rigid supervisory procedures."²⁶⁸

Subsequent congressional investigations focused on tax laws, the primary area of federal jurisdiction over charities. At his death in 1947, Henry Ford kept

261. *Id.* at 125.

262. *Id.* at 127. *Indeed, I am familiar with an example where a client asked that a portion of the residuary of her estate be donated to a certain university, and the draft will came back donating the amount to the endowment of the university. The client substituted a clause expressly stating "for any purpose, and not for endowment."*

263. "Nesslerode...lived a diplomat, but is immortal as a pudding." *Id.*

264. *Id.* at 126.

265. *Id.*

266. HALL, *supra* note 247, at 48.

267. FREMONT-SMITH, *supra* note 14, at 51 (citing COMMISSION ON INDUS. RELATIONS, INDUSTRIAL RELATIONS: FINAL REPORT AND TESTIMONY, S. DOC. NO. 64-415 (1916)).

268. *Id.* (citing S. DOC. NO. 64-415, at 85).

the voting stock in Ford Motor Company in his family while leaving the nonvoting stock to the Ford Foundation.²⁶⁹ The federal income tax having been extended to the broad population in order to finance World War II, politicians as well as journalists worried that a tax-sensitive public would hardly accept as charitable the use of Ford's foundation to avoid taxes and concentrate wealth while promoting a liberal policy agenda.²⁷⁰ A congressional committee caught up in the Red Scare of the early 1950s probed foundations and other nonprofits "especially to determine which such foundations and organizations are using their resources for un-American and subversive activities or for purposes not in the interest or tradition of the United States."²⁷¹ In the end, though, the committee's final report urged that even greater contributions be made to these worthwhile entities.²⁷² Another congressman, B. Carroll Reece, pressed on. Also failing to prove organized philanthropy guilty of supporting communism, he nonetheless again exposed the way that foundations can help preserve vast private wealth, while being administered by donors and professional managers (the "philanthropoids") to influence research, education, and the media.²⁷³

During the 1960s, Congressman Wright Patman called for suspending the creation of tax-exempt foundations; limiting the life of foundations to twenty-five years; imposing a 20% tax on foundation income; prohibiting foundations from borrowing or lending money; and requiring that all contributions and capital gains be spent currently.²⁷⁴ The Treasury Department responded with a report in 1965.²⁷⁵ Far milder than the Patman proposals but still radical, the Treasury report recommended such major legislative changes as prohibiting business dealings between donors and foundations; limiting foundation ownership of voting control of businesses; restricting the deductibility of donor-controlled gifts;²⁷⁶ and

269. HALL, *supra* note 247, at 64 (the foundation promptly sold the stock at an immense profit).

270. *Id.* Foundations, of course, are also found on the right. *See, e.g., id.* at 290 n.183 (Howard Hughes).

271. *Id.* at 67-68, 291 n.191 (quoting from H.R. Res. 561, in *Hearings Before the Select Comm. to Investigate Tax-Exempt Foundations and Comparable Organizations*, 82d Cong., 2d Sess. 1 (1952)).

272. *Id.* at 68.

273. *Id.* at 69.

274. *Id.* at 71.

275. TREASURY DEPARTMENT REPORT ON PRIVATE FOUNDATIONS, Printed for Use of the Committee on Ways and Means, U.S. House of Representatives, 89th Cong., 1st Sess. (Comm. Print Feb. 2, 1965).

276. Foundations can function as "incorporated checkbooks" for individual donors. That is, the taxpayer could form a foundation today; make a contribution to it (and claim income tax deductions today, subject to percentage of income limits); and decide in a later year how to give away the money. *See, e.g.,* Thomas Parrish, *The Foundation: "A Special American Institution,"* in *THE FUTURE OF FOUNDATIONS* 7, 18 (Fritz F. Heimann ed., 1973). However, Congress rejected a Treasury proposal to defer a deduction for a contribution until the donor's controlled foundation spent the contributed asset or devoted the property to active charitable operations, or the donor's control over the business or asset terminated. *See* TREASURY DEPARTMENT REPORT ON PRIVATE FOUNDATIONS, *supra* note 275,

regulating the number of years that donors and their families could serve on governing boards.²⁷⁷ Many, but not all, of Treasury's proposals found their way into the Tax Reform Act of 1969, along with restrictions on political activities.²⁷⁸ The new limitations (except for the new rules on political activities) apply only to private foundations, and not to universities, hospitals, or other "public" charities.

Under prior law, a donor could, and often would,²⁷⁹ endow the foundation with voting stock in his closely held corporation. This preserved control in the hands of the founder (and his trusted foundation managers).²⁸⁰ Nor would his foundation make untoward demands for dividends from the corporation.²⁸¹ The 1969 Act requires private foundations to divest control stock, permitting them generally to own no more than 20% of an unrelated business (reduced by the percentage owned by "disqualified persons").²⁸² In addition, the tax code imposes a

at 41-42.

277. In contrast to Courtney Kenny's view of the salutary affects of donor involvement, the Treasury study would have limited board membership by the donor and his family to 25% of the seats after the foundation's first 25 years. The TREASURY DEPARTMENT REPORT ON PRIVATE FOUNDATIONS, *supra* note 275, at 9, explained:

While close donor involvement with a foundation during its early years can provide unique direction for the foundation's activities and infuse spirit and enthusiasm into its charitable endeavors, these effects tend to diminish with the passage of time, and are likely to disappear altogether with the donor's death. On the other hand, influence by a donor or his family presents opportunities for private advantage and public detriment which are too subtle and refined for specific prohibitions to prevent; it provides no assurance that the foundation will receive objective evaluation by private parties who can terminate the organization if, after a reasonable period of time, it has not proved itself; and it permits the development of narrowness of view and inflexibility in foundation management.

278. Pub. L. No. 91-172, 83 Stat. 487 (1969), added Chapter 42 to the Internal Revenue Code. Note that the political climate had drastically changed: The Johnson administration produced the 1965 Treasury Report; the 1969 Act came on Nixon's watch.

279. As of the end of 1968, stock in which the donor and his family owned at least 20% "accounted for 44 percent of all contributions to foundations and 70 percent of the contributions to foundations with over \$100 million in assets." PETERSON COMMISSION REPORT, *supra* note 44, at 72. In some cases, foundations were endowed with, and remained invested in, "specific assets in the form of land, buildings, or mineral rights." NIELSEN, *supra* note 253, at 279.

280. For example, as of 1968, \$482 million of the Duke Endowment's \$629 million in assets remained in Duke Power Company stock, representing a 55% interest. Duke Power was also heavily represented on the foundation's board. In 1963, the North Carolina Supreme Court had denied the trustee's request to revise the investment provisions of the trust indenture, so as to permit diversification. NIELSEN, *supra* note 253, at 184. The trustees received court approval to comply with the Tax Reform Act of 1969 in *Davison v. Duke University*, 194 S.E.2d 761 (N.C. 1973).

281. Parrish, *supra* note 276, at 28 (Robert Bremner had observed, before the 1969 Act, that "the foundation was irresistible").

282. I.R.C. § 4943 (1994) (taxes on excess business holdings). Specifically, a foundation can own up to 20%, counting shares held by "disqualified persons," of any one

"minimum payout" obligation measured as a percentage of the foundation's value; because a foundation must annually dispense at least 5% of its net investment assets for charitable purposes, unproductive assets are costly to hold.²⁸³

Congress adopted this minimum payout requirement in part to deflect a proposal—added by the Senate Finance Committee but deleted on the Senate floor²⁸⁴—to limit foundations to a forty-year life. The minimum payout alternative came at the suggestion of the Peterson Commission, which observed: "[This] means, in effect, that the right to perpetual life must be earned and will not be conferred as an automatic privilege."²⁸⁵ Not everyone agreed. Wrote one observer a few years later:

To condition continued existence on sound investment decisions is not necessarily to reward the foundations whose charitable performance is best. Indeed, there is a quantitative inconsistency in the argument, for a foundation that regularly exceeds the high payout will gradually wither away; the more devoted a foundation is to doing its small part toward meeting what the commission called

business entity; they together may own up to 35% if a third party has effective control. Moreover, this rule ignores any ownership interest not exceeding 2% of a company. A foundation can be invested 100% in a very large company without violating section 4943. For example, in 1971 over 40% of the Rockefeller Foundation was invested in three Rockefeller oil companies, but the Foundation held only 1.5% of the oil companies' stock. NIELSEN, *supra* note 253, at 72. Separately, however, section 4944 taxes "jeopardizing investments," which in theory should include a severely undiversified portfolio. *See* Treas. Reg. § 53.4944-1(a)(2)(i) (1972) (prudent trustee standard includes the need to diversify); *cf.* Gen. Couns. Mem. 39,537 (July 18, 1986), *concurring in* Tech. Adv. Mem. 86-31-004 (Apr. 14, 1986) (highly leveraged investment of 75% of foundation's assets in a single company of which foundation managers are employees, although less than 2% of the stock, violates section 4944). However, holding concentrations in donor-designated stock does not appear, without more, to violate the private foundation excise tax regime. Reform in this area would be welcome, to signal to the foundation world that the beneficiaries' interests take precedence over the donor's desire to place his stock in friendly hands. *See* BRODY, *supra* note 19, at 81-85.

283. I.R.C. § 4942 (1994) (taxes on failure to distribute income by private nonoperating foundations; operating foundations must meet separate tests) (as originally enacted, Congress required the foundation to expend whichever was greater, its investment income or a specified percentage of its net investment assets). Observed the Peterson Commission: "Selection of an appropriate payout percentage involves a balancing of priorities between the present and the future." PETERSON COMMISSION REPORT, *supra* note 44, at 148.

284. *See* NIELSEN, *supra* note 253, at 16-17 (quoting from floor debate). One du Pont advisor, however, praised the idea: "On balance, I am in favor of a forty-year limit on the life of foundations. The danger is that after that they fall into the hands of the damned sociologists." *Id.* at 149.

285. PETERSON COMMISSION REPORT, *supra* note 44, at 172; *see also* Parrish, *supra* note 276, at 38 (Congress seized on the Peterson Commission's suggestion for a minimum payout obligation as "a viable alternative to the proposal to limit the life of foundations to a fixed term which had gathered strong support").

"the charitable crisis of the 1970s," the less likely it is that it will ever see the year 2000.²⁸⁶

The private foundation world has adjusted to its new restrictions.²⁸⁷ In 1975, foundation assets represented one-seventh of total nonprofit assets; by 1982, one-fifth.²⁸⁸ New foundations have surged. The 22,088 grant-making institutions in 1980 exploded to 37,571 by 1993.²⁸⁹ Private foundations have not only preserved wealth, but grown, paying out little more than the 5% minimum for charitable purposes.²⁹⁰ The community foundations also thrive, often attracting contributions

286. John R. Labovitz, *1969 Tax Reforms Reconsidered*, in *THE FUTURE OF FOUNDATIONS*, *supra* note 276, at 101, 113.

287. See Elizabeth T. Boris, *Creation and Growth: A Survey of Private Foundations*, in *AMERICA'S WEALTHY AND THE FUTURE OF FOUNDATIONS*, *supra* note 101, at 65, 101 tbl.4-A4 (7.9% of foundations terminated in 1970, 14.3% in 1971, 16.5% in 1972, 9% in 1973 and in 1974, and then falling each year to 1.4% in 1982); see also *id.* at 72 (almost one-third of foundations with more than \$5 million disposed of excess business holdings, but only 12% of smaller ones).

288. Teresa Odendahl, *Independent Foundations and Wealthy Donors: An Overview*, in *AMERICA'S WEALTHY AND THE FUTURE OF FOUNDATIONS*, *supra* note 101, at 1, 29-30.

289. LOREN RENZ ET AL., *FOUNDATION GIVING: YEARBOOK OF FACTS AND FIGURES ON PRIVATE, CORPORATE, AND COMMUNITY FOUNDATIONS* 22 & fig.9 (1995 ed.). "A number of the rich and famous created foundations," including Liz Claiborne, David Geffen, Anne and Gordon Getty, J. Willard Marriott, Michael Milken, George Soros, Barbara Streisand, Ted Turner, Sam Walton, and Andy Warhol. *Id.* at 29. Moreover, a surge of new foundations (or contributions to existing foundations) is expected in the brief window of opportunity created by Congress in 1996 legislation. Until May 31, 1997, a donor who contributed appreciated securities to a private foundation enjoyed the rule that applies to contributions to publicly supported charities (and community foundations): The donor may deduct the fair market value of the property, and not just the donor's basis in it. See I.R.C. § 170(e)(5) (1994); Monica Langley, *A Tax Break Prompts Millionaires' Mad Dash To Create Foundations*, *WALL ST. J.*, Jan. 27, 1997, at A1. The Taxpayer Relief Act of 1997 extended this break through June 30, 1998. Pub. L. No. 105-34, sec. 602 (1997).

290. In 1992, the median of all nonoperating foundations paid out 6.5%; the smallest (under \$100,000 in assets) distributed 11.7% (often, the donors funnel annual contributions through the foundation); the largest (\$100 million or more) distributed exactly 5%. Meckstroth & Arnsberger, *supra* note 68, at 78 & fig.1; see also *id.* at 79 ("The trend of the large foundations to give consistently at a payout rate of 5.0 percent seems to demonstrate their use of long-range planning in setting grantmaking budgets. [Lester] Salmon, in a survey of the payout policies of foundations, found that smaller foundations, as a group, tend to use their investment yields to help to structure their charitable payout rates, while the larger foundations, as a group, tend to structure their investment decisions in order to reduce the effect of the payout requirement on their assets."). While the recent surge in the stock market means that foundations will distribute more dollars, the percentage distribution is not expected to change radically. See, e.g., Marina Dundjerski, *A Boom Year: Ford's Giving to Rise 18%*, *CHRON. PHILANTHROPY*, May 1, 1997, at 1, 13 (stating that the Ford Foundation, whose endowment grew by \$1 billion since 1995 to \$8.4 billion, gave away 5.3% of its asset value in 1996; it "estimates that, taking into account expectations for the performance of its portfolio, its spending this year will represent the same percentage"). See generally Debra E. Blum & Paul Demko, *Will 1997 Be a Boom Year for Grants?*,

from those not wealthy enough to establish free-standing foundations.²⁹¹ Indeed, proprietary investment managers are getting in the act, pioneered in 1992 by Fidelity Investments' "Charitable Gift Fund."²⁹²

E. Summary of Part II

This historical review serves to remind us of the role played by charitable endowments in society. As that role evolves, however, our legal rules can adapt. When charitable endowments meant land holdings, endowments presented a threat that no longer exists once charities invest predominantly in intangible assets. At the same time, wealth in whatever form attracts attention from other sectors of society. While Henry VIII enjoyed the political support for an outright seizure of monastic properties for the crown (to remove pressure for revenues from the middle class), the twentieth-century United States Congress did succeed in making private foundations provide at least some social benefits on a current basis. Nevertheless, as charity metamorphoses from church-based to large donor-based to widely supported, we still find charities building permanent endowments and other long-term reserves. Why they do this, and how the law should respond, are considered in the next, and final, part of this Article.

III. LEGAL REFORM AND ITS LIMITATIONS

This final Part begins by analyzing the value of perpetual endowments as a matter of *spending* policy. Fundamentally, defenses rest on notions of intergenerational equity: that endowment should be managed by taking the needs of

CHRON. PHILANTHROPY, Feb. 20, 1997, at 1.

Occasionally, we find the rare foundation that spends itself out of existence. See, e.g., Brendan Gill, *A Party for Brooke*, NEW YORKER, Apr. 21, 1997, at 72, 76 (describing Brooke Astor's decision to wind up the Vincent Astor Foundation, which she has run since 1960, by giving away its remaining \$25 million to about 50 New York organizations that the foundation has previously supported; she took the advice of John D. Rockefeller III, who told her, "The person who has control of the money should also be personally involved in the giving. It is a lot of work, but it's worth it.").

According to a recent survey, almost a third of the respondents agreed with the statement: "Private foundations should have to give away all their money after a certain period of time." Debra E. Blum, *Americans Say They Want Foundations to Be More Accountable*, CHRON. PHILANTHROPY, May 1, 1997, at 14 (roughly equal percentages either disagreed or were unsure). It is difficult to know what to make of such summary findings.

291. Since 1984, community foundations increased by almost 50%, to 374; just 1% of total foundations in 1993, community foundations awarded 6.5% of grant dollars, and received 11.1% of foundation gifts. RENZ, ET AL., *supra* note 289, at 44. Of \$9.7 billion in assets, endowment came to just \$857 million. *Id.* at 45 tbl.45, 46; see also George Johnson & David Jones, *Community Foundations*, in EXEMPT ORGANIZATIONS CONTINUING PROFESSIONAL EDUCATION TECHNICAL INSTRUCTION PROGRAM TEXTBOOK 1993 (FOR FY 1994) 135. See generally Hall, *supra* note 251, at 194 (Politically conservative, many newer community foundations regarded "locally focused voluntary activity as an important alternative to government action while shying away from the private foundation form, which was tainted with an aura of liberalism.").

292. See Stephen G. Greene, *Financial Titans' Move into Charity*, CHRON. PHILANTHROPY, Nov. 28, 1996, at 1.

each generation into account. However, economist and law professor Henry Hansmann has persuasively analyzed, and rejected, many common and not-so-common arguments made to justify university endowments on grounds of intergenerational fairness.²⁹³ Yet if we challenge the value of charitable saving on grounds of intergenerational equity, we can also make many of the same arguments against private (family) saving.

Accordingly, we turn to notions of "stewardship," and how society uses charitable endowments to *save*. By focusing on where the principal goes, rather than on where the income goes, we can see that endowments (and other surpluses) provide a large pool of investment capital to society. The concept of stewardship bears an uncanny resemblance to the current environmental movement of "sustained development." However, unlike many natural resources, modern forms of capital are renewable. Indeed, the theoretically unlimited amount of financial assets makes wealth holding by charities not scary in the way that land holding scared supporters of mortmain legislation.

While inalienability no longer presents a concern, it remains true that wealth provides power in society. If, as the data suggest, charities like to maintain (if not hoard) their resources, is this a bad thing? If not, then we should be satisfied with proposals to reform the *cy pres* doctrine. Because trustees do not often want to invade the endowment, we should not expect to see much behavioral change from a reform that permits trustees to ignore an income-only restriction (perhaps only after a certain period of time). As a result, it would not hurt, and could greatly help in specific situations, to give trustees more discretion in spending funds.

If, however, society believes that saving through the charitable sector is a bad thing, then, in order to induce real change, legal reform would have to go further. The obvious, easy solutions likely would not work. For example, rules that merely sunset the charity fund after a specified time period would not alter the *net* amount of saving in the charitable sector if charities, rather than expending the corpus, can merely transfer the fund to another charity. Thus, the effectiveness of such a proposal would have to depend on any one charity's preferring to spend down its assets rather than see them reassigned within the sector. Moreover, spending against the clock would undoubtedly be wasteful.

Major charitable institutions have long been part of the elite political economy. "In the form of universities, medical research centers, hospitals, museums, art collections, and the like, the nonprofit sector, protected by tax exemption, is the permanent home of old wealth in American society."²⁹⁴ However, the success of universities, museums, and other peer-group charities in raising small amounts for endowment suggests that the middleclass also supports saving

293. Note that perpetual charitable funds create a mismatch between the generation that provided the benefactor's wealth and the generations that will enjoy it. However, if each generation produces new wealth and new charities, in the "steady state" mismatches should smooth out.

294. GEORGE E. MARCUS WITH PETER DOBKIN HALL, *LIVES IN TRUST: THE FORTUNES OF DYNASTIC FAMILIES IN LATE TWENTIETH-CENTURY AMERICA* 9 (1992).

via the charitable sector. But do these financially healthy institutions need *public* subsidy? Perhaps the best legal reform involves more selective tailoring of tax and other subsidies granted to the charitable sector. Indeed, if society needs to use public resources to help private parties supply public goods, then subsidies might better be based on outputs, rather than on inputs determined by the organizational form as "charity" or "business." The appropriate subsidies are beyond the scope of this Article, and will form the basis for my future research.

A. Spending Policy and Intergenerational Equity

As a threshold matter, do existing endowments constitute a social compact in which each generation promises not to "invade capital," but to pass on at least as much as it inherited? Some might worry that freed-up trustees could claim an enormous windfall for the current generation. To turn the question around, however, we also cannot ignore the mismatch between the generation that provided the donor's wealth and the generations that will enjoy it. Just a hundred years ago, America was getting its first look at a new class of citizen, the superwealthy. The fortunes made by industrial magnates boggled the imagination, but were not acquired without strong criticism of the social costs in their getting. The public still enjoys, through the spending of their private foundations, the resources amassed by Andrew Carnegie, John D. Rockefeller, and Henry Ford. But while theirs was the first American generation to accumulate great fortunes and give them away, we need not act as if it is also the last. The twentieth century has continued to produce major philanthropists, and Warren Buffett, Bill Gates, and lesser titans promise to carry on the tradition into the new millennium.²⁹⁵ In theory, charitable foundations could reach a "steady state," where the income from the accumulation of existing foundations matches the lump-sum amounts that fund new foundations.

We cannot determine who wins and who loses from particular expenditures without knowing which generation is better off than the others. This question requires us to think of "saving" the way the economists do—anything that is not current consumption is investment. Thus, spending on infrastructure or on the acquisition of human capital (such as health or education) cannot be counted as consumption unless the benefits will be entirely depleted by the spending generation. Otherwise the costs should be allocated to the benefited generations. (I am not claiming that making this allocation is easy.)²⁹⁶ This debate echoes the

295. See, e.g., Carey Goldberg, *Computer Age Millionaires Redefine Philanthropy*, N.Y. TIMES, July 6, 1997, at A1 ("Charity specialists are watching with fascination as Microsoft disciples begin to try to remake the Puget Sound nonprofit world into their own image, introducing into the sometimes stodgy world of philanthropy a high-energy, high-tech, hard-core business approach...." Microsoft's "AlumNet" has 1100 members, of whom about 40% "are mainly interested in nonprofit work.").

296. Akin to the question of university endowment spending is the question of government funding for outright student aid versus student loans. Some have claimed that a shift from grants to loans represents a shift from the older to the younger generation. However, one must distinguish between the *legal liability* and the *economic incidence* of the burden. When the government bestows college grants, who pays? It is tempting to say

broader debate over the burden of the federal debt, and the wisdom of deficit spending.²⁹⁷

Universities accept the premise of endowments, as revealed by one well-known study: "The contemporary view of prudence is that trustees should weigh the needs of today against those of tomorrow. Consideration should be given to the expected total return and risk of investments, as well as to prospective gifts, general economic conditions, and price-level trends."²⁹⁸ That study identified three general types of "endowment strategies": (1) *generational neutrality*, which plans to grow the endowment to ensure constant real spending; (2) *enhance the institution*, which increases spending to improve the school now; and (3) *build the endowment*, which reduces endowment spending to enable substantial increases in future endowment spending.²⁹⁹ The decision to adopt one of these strategies must be justified on normative grounds, determined by "how the trustees visualize the educational objectives of the institution and the role that endowment spending is to

"current taxpayers"—who are much more likely to be the parents of the students than the students themselves. However, the government cannot definitively impose costs on any particular generation, and the grants might actually be borne by each generation of college students themselves, through higher taxes during their working lives. See Evelyn Brody, *Paying Back Your Country Through Income-Contingent Student Loans*, 31 SAN DIEGO L. REV. 449, 463 (1994).

297. See LAURENCE J. KOTLIKOFF, *GENERATIONAL ACCOUNTING: KNOWING WHO PAYS, AND WHEN, FOR WHAT WE SPEND* 165–85 (1992) (the 1950s through the 1970s represent the greatest era of increasing burdens on future generations, while the 1980s—largely due to Social Security funding reforms—actually benefited future generations); Brody, *supra* note 296, at 460–62 (discussing Alan J. Auerbach et al., *Generational Accounts: A Meaningful Alternative to Deficit Accounting*, in 5 TAX POL'Y & ECON. 55, 57 (David Bradford ed., 1991) (positing "generational accounts" to illuminate how much "different generations [are] paying to finance government consumption and to subsidize each other")); Robert Eisner, *Deficits: Which, How Much, and So What?*, 82 AM. ECON. REV. PAPERS & PROC. 295, 297 (1992) (the deficit is not measured right if government expenditures are "financing real government investment in public capital or private households' investment in durable goods or human capital"); David M. Cutler, *Generational Accounting: Knowing Who Pays, and When, for What We Spend*. By Laurence J. Kotlikoff, 46 NAT'L TAX J. 61, 66 (1993) (book review) ("Kotlikoff's generational accounts ignore the distribution of non-entitlement spending, since it is unclear *ex ante* how much each generation values them. One could argue, however, that the returns to military spending in the past several decades have been very large."); *id.* at 64 ("A fair reading of the evidence is that the available evidence does not offer firm conclusions about the economic effects of the deficit."); see also Peter Diamond, *Generational Accounts and Generational Balance: An Assessment*, 49 NAT'L TAX J. 597, 605 (1996) ("I conclude that the role of generational balance is in the political economy realm, not that of normative economics.... [T]he question is the utility of going beyond the use of generational accounting to assess the differential incidence of alternative government policies and calling for generational balance."); Robert Haveman, *Should Generational Accounts Replace Public Budgets and Deficits?*, 8 J. ECON. PERSPECTIVES 95 (1994).

298. WILLIAMSON, *supra* note 42, at 5–112.

299. *Id.* at 5–112 to 5–113 (noting that the generational neutrality strategy is most common).

have in achieving those objectives."³⁰⁰

The traditional statement of endowment management, however, does not seem to allow for much questioning of the intergenerational-equity goal, at least as a first approximation. Papers written for a 1974 conference of the American Economics Association on endowment management premised their analysis on a goal of perpetuity. Yale economist James Tobin asserted from the outset:

The trustees of an endowed institution are the guardians of the future against the claims of the present. Their task is to preserve equity among generations. The trustees of an endowed university like my own assume the institution to be immortal.... Sustainable consumption is their conception of permanent endowment income. In formal terms, the trustees are supposed to have a zero subjective rate of time preference.³⁰¹

James Litvack, Burton Malkiel, and Richard Quant introduced their description of Princeton's endowment formula by asserting: "University trustees have a clear obligation to protect the corpus of an endowment fund...."³⁰² By "corpus" they meant the real value of the endowment. If the Princeton plan produced a 9% "total return" (interest, dividends, and realized and unrealized gains) at a time of 5% inflation, then 4% (applied to a moving average) remains for spending.³⁰³ Robert Eisner criticized these still-conservative spending policies as "reinforc[ing] and perpetuat[ing] the university practice of using endowments to build forever for the future. Jam tomorrow, but never jam today!"³⁰⁴ Professor Eisner continued:

Why should we act as if a university or any other institution is permanent? We know that nothing is permanent. We know that we are mortal. We know that needs change and we can anticipate that the needs for endowment income can change.... Indeed, almost nowhere in human behavior or in economic activity do we show a zero rate of time preference. We are always giving more weight to the present than to the future.³⁰⁵

300. *Id.* at 5-112.

301. James Tobin, *What is Permanent Endowment Income?*, 64 AM. ECON. REV. 427, 427 (1974).

302. James M. Litvack et al., *A Plan for the Definition of Endowment Income*, 64 AM. ECON. REV. 433, 434 (1974).

303. *Id.* at 435. Compare Tobin, *supra* note 301, at 429:

[U]nder idealized conditions the university can consume the noninflationary fraction of the earnings of the businesses whose securities it holds. The remainder... must be plowed back to enlarge the endowment enough to keep up with inflation. It may be that the businesses themselves do this reinvestment.... If so, the university doesn't need to save on its own and may have to realize part of its income by selling securities.

304. Robert Eisner, *Endowment Income—Discussion*, 64 AM. ECON. REV. 438, 439 (1974).

305. *Id.* at 440.

Nevertheless, more than twenty-five years later (including some horrendously inflationary years, particularly for costs of higher education), endowment policy continues to seek capital preservation, while spending only a portion of growth. Laurence Hoagland, the chief executive officer of the Stanford Management Company, describes his strategy as seeking to "keep pace with and beat inflation. The university has a lot of expenses that are 'people' expenses, which tend to move in line with inflation."³⁰⁶ Stanford finances such expenses, such as professorships and scholarships, with a long-term—even an indefinite—growth objective.³⁰⁷ Jack Meyer, the president of the Harvard Management Company, asserts: "We have to keep pace with or outperform the growth in university expenses each year, and in addition disburse between 4.5 and 5 percent of the fund's capital value each year."³⁰⁸ Under such a strategy, Harvard spent \$322 million from its endowment in the year ended June 30, 1996, during which time it earned \$1.8 billion.³⁰⁹ The amount of Harvard's *unspent* endowment return could just about have covered its total annual budget of \$1.5 billion!³¹⁰

Professor Hansmann has thoroughly reviewed, and rejected, many equitable justifications for university saving. He begins with the assumption that the present generation needs to sacrifice for future generations:

There is every reason to believe that, over the long run, the economy will continue to grow in the future as it has in the past and that future generations of students will therefore be, on average, more prosperous than students are today, just as today's students are more prosperous than their predecessors. Thus, equity does not call for a transfer of wealth, through saving, from the present generation to later ones. On the contrary, it would seem more equitable to have future generations subsidize the present. This could be accomplished by having universities borrow, rather than save, and then repay the debt by increasing tuition in the future.³¹¹

Hansmann then deplors the "conventional wisdom" that "ignor[es] the prospect of future gifts to endowment in undertaking an intergenerational welfare analysis": "Ignoring it is little better than ignoring future tuition income or future faculty salaries. The larger the future gift income, the more reason to spend, not save, current gift income."³¹² Julius Rosenwald understood the tradeoff,

306. Martin Baker, *Universities Are Often Smart Investors*, INT'L HERALD TRIB., Feb. 13, 1996, at "Special Report."

307. *Id.*

308. *Id.*

309. Bary, *supra* note 4, at 31.

310. *See id.*

311. Hansmann, *supra* note 20, at 14.

312. *Id.* at 16; *see, e.g.*, Tobin, *supra* note 301, at 427 ("[C]urrent consumption should not benefit from the prospects of future gifts to endowment. Sustainable consumption rises to encompass an enlarged scope of activities when, but not before, capital gifts enlarge the endowment.") Tobin regards gifts for current use as "highly uncertain, and their fungibility is generally limited both in use and in time. It is reasonable...to let total budgets fluctuate as soft money comes and goes." *Id.*

commenting: "It is true that money disbursed now will not yield income to the University fifty years hence, but it is also true that fifty years hence other contributors can be found to supply the needs of that generation."³¹³

Charities tend to save some of their nominal endowment income in order to preserve the real endowment value against the depredations of inflation. Preserving the purchasing power of wealth becomes especially difficult in subsectors where the general inflation rate falls short of the subsector's increasing costs, as has been occurring in higher education.³¹⁴ To Hansmann, though, the argument that rising costs require saving is completely backwards: "If education in future generations will be costlier than it is at present, then there is no reason to consume less of it today in order to consume more of it in the future. This would simply be substituting a more expensive good for a cheaper one."³¹⁵

Hansmann next considers the risk of falling demand for the university's services or of technological innovations that make other forms of education more effective.³¹⁶ These possibilities lead him to "apply a positive discount rate to expenditures out of a university's endowment, even if we do not discount future utilities."³¹⁷

Finally, Hansmann rejects a notion that colleges are necessarily better at saving than at engaging in charitable functions.³¹⁸ Comparing passive investment with charitable-purpose investment, Hansmann observes: "[W]hen a university

313. Rosenwald, *Principles*, *supra* note 254, at 124.

314. See Joel C. Dobris, *Real Return, Modern Portfolio Theory, and College, University, and Foundation Decisions on Annual Spending from Endowments: A Visit to the World of Spending Rules*, 28 REAL PROP. PROB. & TR. J. 49, 70 (1993) (describing Harvard University's policy); see also DAN WINGERD ET AL., A CHARTBOOK OF TRENDS AFFECTING HIGHER EDUCATION FINANCE 1960-1990 (Common Fund 1992).

315. Hansmann, *supra* note 20, at 17.

316. For one of many recent news stories, see Steve Lohr, *When the Alma Mater Ends With 'edu.'*, N.Y. TIMES, July 7, 1996, § 4, at 2. See also Paul Krugman, *White Collars Turn Blue*, N.Y. TIMES MAG., Sept. 29, 1996, at 106. In this essay, Professor Krugman, pretending to be looking back from year 2096, claims that we should have easily foreseen that because of technology, most jobs would come to require little education:

So enrollment in colleges and universities has dropped almost two-thirds since its peak at the turn of the century. The prestigious universities coped by reverting to an older role. Today a place like Harvard is, as it was in the 19th century, more of a social institution than a scholarly one—a place for children of the wealthy to refine their social graces and befriend others of their class.

Id. at 199.

317. Hansmann, *supra* note 20, at 17 & n.30 (citing to Eisner, *supra* note 304).

318. See also Bary, *supra* note 4, at 38 (quoting Harvard benefactor Byron Wien, a Morgan Stanley executive who solicits large gifts from alumni in the financial community: "Since Jack Meyer has come to Harvard, the investment performance has been excellent, and I think that makes big givers feel better about writing checks to Harvard now. In the past, when the investment performance wasn't as good, people would say: 'I can manage the money better than Harvard so I'll leave it to the university in my will.'")

adds a dollar to its endowment for the purpose of making an intergenerational transfer, it is implicitly making the judgment that the dollar will have a higher rate of return if invested in stocks and bonds than in educating an undergraduate, or doing research in biophysics, or adding books to the library.³¹⁹ Less dispassionately, Rosenwald, a trustee of the University of Chicago, complained so long ago: "[T]hrough we have endowments of \$43,000,000 we have frequently been unable to authorize the use of even a few thousands for some object which would add much to the University's resources and usefulness, to say nothing of its prestige. We may not even convert the principal of our endowments into books or men, which are the real endowment of any university."³²⁰

Economist Burton Weisbrod feels forced to conclude that the university pecking order must not depend on educational expenditures, or else "it's not in the objective function of university trustees to move up in the pecking order."³²¹ Rather, many university trustees come from the business world, and so feel comfortable focusing on the easily measured success of investments; "one sometimes has the sense that universities compete among themselves to have the largest endowment."³²² Hansmann dryly calls this behavior Veblenian conspicuous nonproduction, "since an endowment, in a sense, represents accumulated income that the university has been able to afford *not* to spend on education and research."³²³ Perhaps, he says, we should call them "directors": "if a university trustee asks herself what she is a 'trustee' of, she might naturally conclude that...she is a trustee of the endowment fund and that it follows that she has a special responsibility to make certain that the fund is retained intact."³²⁴

I agree with all of Professor Hansmann's points, and the other intergenerational equity arguments against charitable endowments. However, one could easily make the same arguments in examining private saving.³²⁵ Why should

319. Hansmann, *supra* note 20, at 17.

320. Rosenwald, *Principles*, *supra* note 254, at 123. For even the most highly endowed universities, "restricted endowment income simply does not make up a large enough portion of the operating revenue...to severely limit the flexibility of management." NACUBO, ENDOWMENT MANAGEMENT, *supra* note 9, at 10. However, new restricted funds "can even worsen [a university's] financial condition if they fail to cover fully the incremental costs of new activities" that they demand. WILLIAM G. BOWEN ET AL., THE CHARITABLE NONPROFITS 170 (1994). As can be expected, charities often decline the contribution of a white elephant.

321. Observation made by Burton Weisbrod at a workshop I gave on this paper at the Institute for Policy Research, Northwestern University (Mar. 7, 1997) (notes from this workshop are on file with the author).

322. Hansmann, *supra* note 20, at 37.

323. *Id.* at 38. To the extent universities seek high "endowments" in order to obtain high bond ratings (and lower interest rates), as discussed *supra* Part I.C, why don't they simply spend an equivalent amount of savings? If they borrow just to take advantage of rate differentials, then perhaps the arbitrage rules need tightening.

324. Hansmann, *supra* note 20, at 39.

325. See Hirsch & Wang, *supra* note 142, at 38 n.146 ("The goal of intergenerational capital accumulation is inherently normative, for it is impossible to value

not each generation expend all of its wealth (especially through investment in human capital, such as educating its children)?³²⁶ After all, wise expenditure will increase the productivity of the successor generation.³²⁷ If spending policy does not provide a satisfactory answer to the endowment question, perhaps savings policy will.

B. Savings Policy and the Stewardship Theory

The inescapable fact is that charitable endowments, and the unconstrained behavior of charity fiduciaries, closely resemble the dynastic private savings pattern, whose motto is, "Never dip into capital."³²⁸ Traditionally, the question of spending principal never arose because a noninvadable pool of wealth consisted of an asset that could not be "spent." For many centuries, dynastic wealth took the form of land; family members enjoyed the fruits of the earth ("income") while preserving the real estate ("corpus") for descent to succeeding generations. Similarly, the idea of a perpetual fund for charity undoubtedly originated from the fact that, at the time the English legal structure for private charity developed, most donations took the form of land.³²⁹

objectively such a reallocation." (citing to Armartya K. Sen, *On Optimising the Rate of Saving*, 71 *ECON. J.* 479 (1961), and other views, including those of Rawls and Posner)).

326. See John H. Langbein, *The Twentieth-Century Revolution in Family Wealth Transmission*, 86 *MICH. L. REV.* 722 (1988). Indeed, if the current generation spends its resources wisely by investing in the next, then to also take money from today's donors and save it for next year's (century's) needy is to "clearly tax the poor to help the rich." Phillip Longman, *Justice Between Generations*, *ATLANTIC MONTHLY*, June 1985, at 73, 76 (quoting from economist Gordon Tullock regarding private saving).

327. George Marcus writes of the "ambitious descendant" beneficiaries of a family trust:

Such parents move to siphon off as much capital as possible from the fortune for their own projects—e.g., by attempting to have earnings on capital declared as income rather than principal [—while offering]...the promise of their own efforts to renew and create wealth in an active way rather than just preserving it....

MARCUS, *supra* note 294, at 101.

328. See generally Lawrence M. Friedman, *The Dynastic Trust*, 73 *YALE L.J.* 547, 548 (1964) (Commonly, "a dynastic trust...[consists] of a chain of life interests, enjoying current income rights, while enjoyment of principal is postponed until the Rule against Perpetuities forces distribution to relatively remote descendants."). Professor Friedman briefly discussed the resemblance between a dynastic trust and a perpetual or long-term charitable trust, which often "serves to perpetuate the family name." *Id.* Most important to Professor Friedman, the charitable trust "has many traits in common with the private dynastic trust—e.g., its long life span, its jealousy of the integrity of its principal, its need for administrative flexibility—and these common traits give rise to common legal needs." *Id.*

329. See, e.g., WILLIAMSON, *supra* note 42, at 5–102 to 5–103:

The *Oxford English Dictionary* indicates that this usage of the word "endowment" dates from the fifteenth or sixteenth century, and indeed the practice of endowing goes back at least to the twelfth century, when substantial quantities of land were dedicated to the perpetual support of ecclesiastical organizations. This land-based origin of endowment funds

The abstract conception of a charitable donation as yielding a perpetual stream of fruits persists in the Anglo-American collective consciousness as the highest form of conducting charity. This conception bears a striking resemblance to the environmental movement, urging only "sustainable development" in order to preserve the earth for our descendants in at least as good a condition as we inherited it.³³⁰ As we feel about stewardship of the earth, we like to think that we will leave for the next generation at least the amount of endowments we received.

However, I find the historical explanation for an "earth metaphor" of perpetual charity only superficially satisfying. Certainly it explains an investment in land by someone *who had already determined to preserve the corpus*. But land never was the only form of wealth, and so never was the only way to fund a charity. Anyone who earnestly wanted to expend wealth for charitable purposes could always have done so. Money long existed. When William I died in 1100, he left to his fourth son, who became Henry I, the enormous sum of £5,000 in silver—and no land.³³¹ Church finance early on became heavily monetized: By the late twelfth century, the tithe was "coming to rival if not to surpass direct [land] ownership as the Church's chief economic support."³³² Indeed, because of its large cash position, the Church began to augment land received as gifts with purchases from those who needed liquidity in order to migrate or participate in the Crusades.³³³ Henry VIII sold most of the seized monastic properties in order to finance his wars.³³⁴ In the seventeenth century, moreover, the urban (mostly London) donors were predominantly merchants, "in average terms a very rich class, and the wealth which

is important, for it explains to a substantial degree the traditional spending practices that have characterized endowment funds up to at least the second half of the twentieth century. The land held by an endowment fund generated rent, with the rental income available for the general purposes of the endowed institution. Land values and rents tended to rise over time, so an increase in rental income enabled endowed institutions to cope not only with rising costs but with expanded activities as well.

330. See EDITH BROWN WEISS, *IN FAIRNESS TO FUTURE GENERATIONS: INTERNATIONAL LAW, COMMON PATRIMONY, AND INTERGENERATIONAL* (1989) (arguing that the current generation holds the natural environment in trust for future generations, which, as beneficiaries, are entitled to use and benefit from it).

331. John Gillingham, *The Normans*, in *THE LIVES OF THE KINGS AND QUEENS OF ENGLAND* 22, 35 (Antonia Fraser ed., 1995) ("At once he left the old King's bedside and hurried to the Treasury to supervise the weighing out of the money.").

332. GILCHRIST, *supra* note 89, at 264 n.69 (quoting D. Herlihy, *Church Property on the European Continent, 701-1200*, 36 *SPECULUM* 81, 98 (1961)). Medieval bishops raised the necessary hard cash to build cathedrals by selling indulgences and other spiritual privileges, although, because of the scale of the projects, the process could take centuries. JOHNSON, *supra* note 198, at 226. Admission fees to view holy relics raised additional funds. *Id.* ("Thomas Becket posthumously paid for much of the rebuilding of Canterbury in the later Middle Ages.").

333. GILCHRIST, *supra* note 89, at 27.

334. Unfortunately for him, by the sixteenth century, Spain's silver mining in the Americas produced horrendous inflation throughout Europe. See, e.g., ROWSE, *supra* note 191, at 108-09.

it possessed gained enormous added power because it was fluid and disposable."³³⁵ Thomas Guy—who caused a scandal by endowing a hospital in his name, thereby inspiring the Modern Law of Mortmain against devises of land—ironically made his fabulous fortune by selling South Sea stock before the bubble burst.³³⁶ Society's ample social welfare needs of any age could have been met by immediate expenditure of large funds.³³⁷

Moreover, we cannot really think of the charitable sector as a finite natural resource. While the private foundation and the explosion in charitable endowments are twentieth-century phenomena, we have no reason to believe that the twenty-first century will not produce as much, if not, greater wealth. As a resource, charity clearly is a renewable resource.³³⁸

Some charities worry that a comfortable balance sheet might "crowd out" fresh contributions. The real question thus appears to be not, "Why do universities have endowments?," but rather, "Why does anyone make a donation to a university with a \$9 billion endowment?" The same thing can happen in dynastic families: preserving and passing on wealth can sap the initiative and productivity of those who follow.³³⁹ Nevertheless, society seems to believe that private saving, whether in families or in charitable institutions, has a value that outweighs the pernicious

335. JORDAN, *supra* note 14, at 327.

336. LANGFORD, *supra* note 93, at 491. In another irony, Guy's Hospital invested its bounty in farmland, whose gross income halved during the agriculture depression of the 1880s. See OWEN, *supra* note 220, at 484.

337. True, in centuries past, holding liquid assets imposed some peculiar administrative burdens:

The absence of accessible investments, such as the Stock Exchange now affords, is vividly illustrated by some of the old directions about the surplus income of Foundations. In one public school...it was to be placed in an iron box under four locks, and to be taken out from time to time to be spent in building houses, and the like.

KENNY, *supra* note 15, at 137–38.

338. Compare Hirsch & Wang, *supra* note 142, at 17–18, where they suggest that dead-hand control had invidious effects only "when a fixed stock of land represented the main source of wealth in society.... But in modern times, when each generation can produce its own wealth, the loss of opportunity to bequeath prior wealth does not clearly crowd later comers to their potential detriment."

339. Langbein, *supra* note 326, at 737, describes billionaire businessman Warren Buffett's intent to leave most of his wealth to charity; having put his children through college, he will leave them only a few hundred thousand dollars. Characterizing such an attitude toward conventional wealth transmission as "exceptional," Professor Langbein traces it to two novel ideas: that wealth is fungible rather than sentimental, and that the duty of wealthy parents is done once they have "achieved for their children the characteristic wealth transfer of modern times, the investment in human capital through education." *Id.* at 737–38. He concludes that "[t]he esteem associated with holding property really now applies only to earned income, to property that embodies the fruits of human capital." *Id.* at 738; see also Dana Wechsler Linden & Dyan Machan, *The Disinheritors*, FORBES, May 19, 1997, at 152, 158 (cover story) ("There is a tendency in our society to show contempt for inherited wealth and to admire self-made wealth.").

effects.³⁴⁰ Indeed, while a high endowment logically should make future donations harder to achieve because the marginal dollar has a smaller impact, it appears to facilitate fund raising because the donor can back a winning peer group.³⁴¹ One might call this the "rich get richer" rule, or the Harvard Syndrome.³⁴²

Some suggest that donors might not realize when charities intend to save the contributions. In particular, the major "health" charities—such as the American Cancer Society and the American Lung Association—have been charged with using misleading fund-raising literature.³⁴³ However, unexamined contributing to popular charities is also consistent with a story in which the act of giving means more to the donors than the uses to which the contribution will be put. Once again, because "it is precisely their sect-like character that gives many altruistic movements their social force,"³⁴⁴ giving becomes belonging.

C. Effective Legal Reform

While modern financial products distinguish today's endowments from those of prior centuries, we would not find such entrenched and strong endowments

340. See Tuckman & Chang, *supra* note 74, at 262–64, for a discussion of the macroeconomic value of surpluses in the charitable sector.

341. See also Hansmann, *supra* note 20, at 33 n.50; *cf.* MARCUS, *supra* note 294, at 158 ("In a sense, Harvard and institutions like it have inherited most strongly dynastic goals that used to be in private hands and generalized them in alumni-school relations.").

342. Forty-seven institutions of higher education with the largest endowments, representing 14% of respondents, received 46% of the total dollar value of donations. 1996 NACUBO ENDOWMENT STUDY, *supra* note 45, at 7. Citing David Packard's donations to Stanford University and Bill Gates' donations to Harvard, nonprofit management scholar Michael O'Neill laments: "That's not exactly rocket science in terms of philanthropy. I'd hope they'd give some of their brilliance to philanthropy, not just shovel tens of millions of dollars to organizations that already have billions of dollars in assets." Linden & Machen, *supra* note 339, at 160.

343. See, e.g., JAMES T. BENNETT & THOMAS S. DILORENZO, UNHEALTHY CHARITIES 83 (1994) (charging that the desperate appeals of the popular health charities do not inform potential donors of their massive fund balances); Carl Milofsky & Stephen D. Blades, *Issues of Accountability in Health Charities: A Case Study of Accountability Problems Among Nonprofit Organizations*, 20 NONPROFIT & VOLUNTARY SECTOR Q. 371, 381 (1991) ("There is a difference...between simplification for the purpose of mass communication and systematic obfuscation of organizational objectives. Few charities, in our experience, make it easy for outsiders or even for their own local fund raisers to know precisely how money is used."). See generally Tuckman & Chang, *supra* note 74, at 264–68 (discussing "contract failure" if the donor would not have contributed had she known that the charity was saving).

344. Milofsky & Blades, *supra* note 343, at 390. "For example, the Shriners Hospitals for Crippled Children have assets about equal to those of our most famous private universities. The organization is based on a system of fraternal organizations that has chapters in nearly every American community." *Id.* at 390–91. These authors continue: "Yet scholars know very little about what this system of organizations does, how it is structured, and why it has accumulated such vast resources. Our ignorance is duplicated for other large charitable organizations." *Id.* at 391.

without a hospitable legal environment.³⁴⁵ The salient trust law features fostering the perpetual charity are the prudent investor rule and the *cy pres* doctrine. Trustees' broad powers of asset management arose in the 1830 Massachusetts Supreme Court decision of *Harvard College v. Amory*: The trustee "shall conduct himself faithfully and exercise a sound discretion. He is to observe how men of prudence, discretion and intelligence manage their own affairs, not in regard to speculation, but in regard to the permanent disposition of their funds, considering the probable income, as well as the probable safety of the capital to be invested."³⁴⁶ To Professor Lawrence Friedman, this rule "presupposes a certain class of trustees: men of business ability, whose social and economic position allows them easily to observe how their peers manage large estates for themselves or others."³⁴⁷ Moreover, the rule originated in Boston, in which a "special institution was developing, the so-called Boston trustee, a professional manager of other people's fortunes—the living embodiment of the prudent investor."³⁴⁸ It took many years before most states accepted the prudent investor rule (for private as well as charitable trustees). Courts and legislatures often relied instead on "legal lists" until, by the turn of the nineteenth century, trust companies developed to provide "a rational, institutional base for legal and business experience in drafting, forming, managing and perpetuating long-term trusts."³⁴⁹ Second, Professor Friedman found

345. I thank Putnam Barber for bringing this point home to me. As he wrote:

There is of course an institutional infrastructure that must be in place to give this sort of impulse any chance of materializing in real endowments—the law of trusts and a reliable market for long-term investments yielding annual returns. The absence of either part would make the whole idea of an endowment impractical. That may be why people in unstable communities prefer tangible acts of charity—throwing up monuments, building actual buildings—rather than contributing to a fund.

E-mail message from Putnam Barber to Evelyn Brody (July 11, 1996) (on file with the author).

346. *Harvard College v. Amory*, 26 Mass. (9 Pick.) 446 (1830). This case contains the famous statement of Judge Putnam that there is no such thing as a "safe" investment: "Do what you will, the capital is at hazard." *Id.* at 460.

347. Friedman, *supra* note 328, at 554. Moreover, to Professor Friedman, the court's focus on "permanent disposition" of funds suggests long-term investment.

348. *Id.* (concluding footnote omitted, in which Professor Friedman finds a division of trustee labor in Massachusetts: "private trustees for dynastic trusts, and corporate trustees and savings banks for small depositors (roughly equivalent to caretaker trusts)").

349. *Id.* at 561, 563. Describing the hazards of relying on the legislature to authorize particular investments, Professor Friedman observed: "It must have been clear to all where the impetus for these laws arose. This was not a plain and narrow path but an invitation to corruption. The power to prescribe 'legals' was a power to control or at least to influence the flow of investment money," *Id.* at 562. Professor Friedman concluded that the Depression provided the spur to final repeal of legal lists: "One might seriously question...the social utility of rules which kept funds out of channels which might conceivably restore business confidence, enhance stock prices, and help get the country back on its feet." *Id.* at 570-71.

that the *cy pres* doctrine, which keeps a charitable trust alive after it can no longer carry out the purposes envisioned by the founder, "is critically important for the dynastic charitable trust."³⁵⁰ Court permission is generally required before the charity can deviate from the donor's wish by spending the endowment principal on critical infrastructure or other charitable needs, and permission evidently does not come easily.

Property, as every first-year law student knows, can be divided into contemporaneous interests and into intertemporal interests. At first, an endowment looks like the first type. After all, legally the charity owns the whole "bundle of sticks," both the income and the corpus. The income-only restriction, however, fragments the endowment into interests that extend out across time. Like a private trust that pays income to the life tenants and the remainder to a succeeding generation, the income from a charitable endowment will be expended for the benefit of a succession of generations (albeit beneficiaries of the same charity).

Accordingly, a charitable endowment more accurately resembles a spendthrift trust, an American institution with no roots in English law.³⁵¹ Indeed, Professor Friedman pointed out that the American legal doctrines permitting flexible investment of charitable trust assets developed at the same time as rules favoring spendthrift trusts. Charitable trusts, being long term or perpetual, "allow a childless settlor to found a bloodless dynasty,"³⁵² while the spendthrift trust is "a natural outgrowth of the desire for the dynastic trust."³⁵³ Nevertheless, one type of spendthrift trust statute (such as that of New York) served more of a "caretaker" goal than a dynastic one, by protecting only so much trust income as was necessary for the care, support, and education of the beneficiary.³⁵⁴ Such a "support trust,"

350. *Id.* at 590.

351. *See generally* Adam J. Hirsch, *Spendthrift Trusts and Public Policy: Economic and Cognitive Perspectives*, 73 WASH. U. L.Q. 1, 6 & n.17 (1995). *See also* Hirsch & Wang, *supra* note 142, at 18-27, discussing the public policy of private trusts that restrict the substantive use of trust income.

352. Friedman, *supra* note 328, at 589.

353. *Id.* at 576. Professor Friedman explained:

Massachusetts, with its early development of "first families" and dynastic trusts, naturally harbored spendthrift clauses and related devices at an early period. In the Gilded Age, the rise of great fortunes and the national flowering of the dynastic impulse increased the pressure on courts to validate the clause. Unlike that other great need of the dynastic trust, investment flexibility, the spendthrift clause could not simply be drafted into a trust, and be honored by the courts as an expression of the settlor's intent. The clause affected the rights of third parties; and prior case-law (the "English rule") and general principles were against it. Specific legal approval was necessary; in the late 19th century this approval was finally attained on a wholesale basis.

Id. at 577 (concluding citation omitted).

354. *Id.* at 583. "It was natural for New York trust law to take a very different turn from that of Massachusetts; in Massachusetts the law's eye was directed primarily toward forward-looking mercantile fortunes, in New York on backward-looking manorial wealth. The *Harvard College* case and the New York property revision were uneasy

however, can also permit invasion of principal if necessary to meet the needs of the current beneficiaries. Professor Adam Hirsch suggests that such an approach might be appropriate in the charitable setting. Nevertheless, he recognizes that the difficulties of anticipating future needs remain.³⁵⁵

Baseball pitcher Dan Quisenberry once summed up a common misperception by observing that the future is "much like the present, only longer."³⁵⁶ Societies change, sometimes with stomach-churning speed. Different societies, at different times and in different places, recognize different needs as worthy of charity. Many functions originally supported by private philanthropy are now performed by the state (for example, education of minors), while others have simply withered away (for example, funds to support those in debtors prison). The intergenerational allocation of an endowment, by definition and by design, imposes today's views on tomorrow's society, and so, for better or for worse, imposes a conservative drag on future resources.³⁵⁷ At the same time, the narrower the purpose of an endowment, the sooner its utility will give way to evolving needs.³⁵⁸ As Owen observed of English charities in the early Victorian period: "Organizations and institutions flowered more luxuriantly than ever, overspecialized, repetitive, and often persisting, according to some mysterious law of charity inertia (sometimes not unrelated to endowments that had been acquired) after the need which called them into existence had vanished."³⁵⁹

The perpetual charitable trust has been called "a balancing of two imponderables."³⁶⁰ Laws enforce perpetual funds for charity because to do otherwise would discourage gifts.³⁶¹ Implicitly the state has determined that net social welfare increases by permitting the dead hand of the testator to govern the enjoyment of wealth into perpetuity. In deciding between devoting their property to

contemporaries." *Id.* at 584. Professor Friedman also found that the South, a landed aristocracy, focused its dynastic impulses on preserving specific estates, rather than on managing portfolios. *Id.* at 555 n.28.

355. E-mail message from Adam Hirsch to Evelyn Brody (Nov. 12, 1996) (on file with the author).

356. See Thomas Boswell, *Quisenberry: Baseball's Main Man*, WASH. POST, Aug. 15, 1983, at D1.

357. See Hansmann, *supra* note 20, at 32 & n.49 ("[A]s Adam Smith forcefully argued, [institutional autonomy] may provide an unfortunate opportunity for irrelevance and sloth." (citing 2 WEALTH OF NATIONS 282-302 (E. Cannan ed., 1976))).

358. Hansmann, *supra* note 20, at 34, expressed this view bluntly:

If perpetual restrictions on the use of property were generally honored by the law, there would thus be a tendency for an ever larger portion of society's wealth to become trapped into outmoded uses. And it is the preferences of the ignorant and short-sighted that would be most honored in the long run.

359. OWEN, *supra* note 220, at 163.

360. SIMES, *supra* note 21, at 117. I expand on the discussion in this paragraph in Brody, *Institutional Dissonance*, *supra* note 246, at 491.

361. Moreover, Professor Hansmann suggests that universities might use quasi-endowment building as a fund-raising technique, to appeal to donors who are willing to make unrestricted donations but would prefer to have the capital maintained. Hansmann, *supra* note 20, at 33.

perpetual charitable use and keeping it in the family, donors take into account the likelihood that their donated property will remain governed by their wishes. Indeed, the *cy pres* doctrine seeks to reform the trust to reflect what the donor would have wanted, had she known of the changed circumstance. But any legal limitation on donor authority will reduce the value of the charitable bequest, both absolutely and relative to the value of an alternate devise.³⁶²

Scholars have long urged reform of the *cy pres* doctrine. Focusing on the evil of donor-directed perpetuity for an increasingly irrelevant purpose, these reformers would free charity fiduciaries from donor-imposed restrictions after the passage of a certain time, whether twenty years, the private trust "lives in being plus twenty-one years," or some other period. It is unclear what is to happen upon the expiration of this limit. May the charity fiduciaries spend the funds for *any* charitable purpose?³⁶³ Would this discretionary power apply just to the use of the income, or does it include the right to invade principal?³⁶⁴ *Must* the charity spend itself out of existence?

To some reformers, however, closer *government* oversight and involvement provides superior results to plenary *trustee* discretion. Courtney Kenny, the Victorian reformer, scoffed at the asserted ownership rights of charity fiduciaries: "[T]his imaginary right of the mere administrators of other men's Foundations has too often been recognized, even by the Legislature, as entitling them to a veto upon the revision of these Foundations; a concession which has marred the working of some valuable Acts of Parliament."³⁶⁵ Kenny still focused on the dictates of the founder, however, in asserting that only the first generation of administrators should have a say in a government scheme for revising an obsolete charity: "Subsequent Trustees know no more than the Revising Authority does of the wishes or beliefs of the Founder, and know much less of charitable economy. A recalcitrant set of Trustees would indeed work the revised foundation in an unsatisfactory manner; but this is rather a reason for changing the Trustees than for refusing to change the Foundation."³⁶⁶

What might we expect to happen from legal reform? If the *cy pres*

362. See, e.g., *Trustees of Dartmouth College v. Woodward*, 17 U.S. (4 Wheat.) 518, 647 (1819) (stating that philanthropy was founded on the hope that the funds would "flow forever in the channel which the givers have marked out for it").

363. See Atkinson, *supra* note 18 (urging this approach).

364. See SIMES, *supra* note 21, at 139 (recommending that trustees be permitted to invade principal after, say, 30 years, regardless of the expressed intent of the donor).

365. KENNY, *supra* note 15, at 185.

366. *Id.* at 219. Kenny recognized, however, that the function of endowments is to "perform services whose importance the State regards as sufficiently great to justify their being undertaken by the nation, but whose character is such that their value would be impaired by their passing into the hands of a bureaucracy." *Id.* at 245. Moreover, Owen suggests that "Courtney Kenny would have failed to discover in the twentieth-century performance of the [English Charity] Commission an approach to the kind of active and imaginative charity administration that [he] had hopefully advocated." OWEN, *supra* note 220, at 329.

doctrine were liberalized, trustees' apparent desire voluntarily to enlarge their reserves suggests that charities would not go crazy and consume their entire endowments.³⁶⁷ Permitting invasion where prudent, though, could greatly rationalize charity management. (Indeed, as described in Part I.B.1, the Uniform Management of Institutional Funds Act effectively permits this for the charity whose endowment has grown—either from inflation or real appreciation—above the historic dollar value when donated.) However, a different legal approach would be needed if society wants to compel charities to minimize their saving. Professors Howard Tuckman and Cyril Chang discuss some of the invasive administrative and normative difficulties of imposing on charities a "maximum rate at which equity can be accumulated and when the level of equity they hold may be excessive."³⁶⁸ Alternatively, they consider applying a private-foundation-type minimum payout obligation on public charities.³⁶⁹

Rather than requiring wasteful spending down of endowment, a better approach might be to eliminate unnecessary subsidies to the nonprofit sector.³⁷⁰ Of course, one way to reduce subsidies is to mandate increased spending. After all, under current law, the endowment income grows free of income tax. If society desires to match current foregone taxes with benefits to current beneficiaries, then the more income the charity currently spends, the lower the value of its tax exemption. However, it is not obvious from a pure policy perspective that the tax system should care about when charitable services are delivered. This is because of the interaction between the donor's charitable contribution deduction and the charity's income tax exemption. Assume, for example, that the donor contributes \$100 to a charity on January 1, and the charity invests the money at 10%, so that it has \$110 at the end of the year. The donor's tax deduction is \$100, and the government has lost the ability to tax the \$10 income. If instead the donor had herself invested the funds, and contributed them at year end, she would have income of \$10, a charitable contribution deduction of \$110, and the charity would have \$110. The tax system is indifferent between the two scenarios; that is, the second scenario is no greater an income tax subsidy than the first.³⁷¹

367. Rosenwald wrote:

I do not advocate profligate spending of principal. That is not the true alternative to perpetuities.... Men who argue that permission to spend principal will lead to profligate spending do not know the temper of trustees, and the sense of responsibility they feel toward the funds entrusted to them; nor do they appreciate the real difficulties which face donors and trustees of foundation in finding objects worthy of support.

Rosenwald, *Principles*, *supra* note 254, at 126–27.

368. Tuckman & Chang, *supra* note 74, at 272–73.

369. *Id.* at 274.

370. *See id.* at 274–75.

371. Matters get more complicated if more than one taxable year is involved. The charity can earn the "inside build-up" tax-free, but so can the donor if she contributes appreciated property (like stock) with unrealized capital gain. I.R.C. § 170(e) (1994). For example, if the donor used the \$100 to buy shares of stock that appreciate to \$121 in value after two years, her deduction would be for \$121, and she would not trigger gain by making

If, however, current charitable spending is important to society, and society wants to use the tax system to encourage that goal, it can subject all or a portion of the charity's investment income to income tax. A broader approach—applicable to contributed amounts as well as to income—would be to adopt a type of "accumulated earnings tax" for charities that do not have concrete plans to spend investment assets within a specified period.³⁷² Because of the variety of social policies involved, though, the resulting tax scheme would not likely be simple. Different levels of savings and investment would probably be appropriate, depending on the type, size, and newness of the charity.³⁷³

D. Charitable Savings in the Political Economy

The wealth held in charitable endowments, like private wealth, must be invested somewhere, and by someone. This is not to say that charities have performed the same function in all societies and at all times, as described earlier in this Article. A thousand years ago in England, the donor-charity relationship was basically a penitent-Church relationship, and charitable foundations enlarged the Church's landholdings. In the seventeenth and eighteenth centuries, secured loans made by charities "were especially common in cloth towns and market towns throughout England, evidently constituting an important source of local entrepreneurial credit"; in the same era, but on a small scale, Harvard made personal loans and mortgages.³⁷⁴ Hall demonstrates how the nineteenth-century Boston Brahmins endowed and controlled the local educational institutions in order to educate their sons in the professions, while, as trustees, they invested the endowments in local businesses.³⁷⁵ In the twentieth century, American would-be dynasties used private foundations to control family business enterprises. Moreover, foundations "provided a framework in which beneficiaries of family trusts could themselves become private fiduciaries, not of family fortunes, but of the public order in general."³⁷⁶ Now required to divest control of family businesses, the private foundations, along with other charities, own a fair-sized percentage of the equity and debt issues of publicly traded corporations.³⁷⁷

The "associated charity" movement began in eighteenth-century England, and continued in the United States in an outpouring of support to membership organizations. Those affiliated with peer-group educational and cultural

the contribution.

372. See *supra* note 20 (describing Henry Hansmann's observation that current law does not apply the corporate "accumulated earnings tax" to exempt organizations).

373. I am grateful to John Simon for this suggestion.

374. JORDAN, *supra* note 14, at 38 (citing to F.G. James, *Charity Endowments as Sources of Local Credit in Seventeenth and Eighteenth Century England*, 8 J. ECON. HIST. 153-70 (1948)); see FOSTER, *supra* note 40, at 158-59.

375. See *supra* notes 247-49 and accompanying text.

376. MARCUS, *supra* note 294, at 69.

377. The influence of any particular institutional investor on any particular company is no doubt much less, on average, than in the nineteenth century. For example, Harvard owns nearly 5000 different securities, including U.S. stocks and bonds, foreign stocks and bonds, real estate, and private placements. Baker, *supra* note 306, at "Special Report."

organizations often have a strong desire to see the organization outlast them, and preserved for the benefit of their children. (Indeed, the edge that alumni children have in college admissions policy has been dubbed the "legacy preference.")³⁷⁸ We might thus expect to find endowments (or quasi-endowments, the voluntary saving by charity managers) in institutions founded by and managed by people who view the perpetuity of the organization and the social institutions it represents as more important than the particular beneficiaries served. Viewing these entities as quasi-clubs rather than as broad social service organizations helps explain such puzzles as why universities do not expand with demand.³⁷⁹ This hypothesis might also explain why some AIDS groups have begun seeking endowments. Their desire to institutionalize appears as much born out of a quest for social legitimacy as to ensure provision of services.

The charitable sector fits oddly into traditional public/private distinctions. While charities represent privately held and managed assets, they perform public services. Furthermore, like other enterprises, they face government regulation. Several congressional investigations this century cast suspicions on the motives and activities of private foundations. During the American foundation world's direst moment, in 1969, one proposal would simply have put a forty-year term limit on the life of any private foundation. The foundations were lucky to escape with just a minimum annual payout requirement, which, these days, is so low that most large foundations have been growing the real value of their endowments. Foundations might not be so lucky next time, and payout requirements could cut into capital. Moreover, Congress could extend mandatory expenditure requirements to publicly supported charities, as suggested by the Filer Commission in 1977.³⁸⁰

A serious imbalance of resources in the nonprofit sector inevitably attracts attention. Not that we will see a reprise of Henry VIII's dissolution of the monasteries,³⁸¹ but a revenue-hungry Congress cannot ignore the wealth held in the

378. Cf. KEETON, *supra* note 17, at 70 ("[T]he bequest for a fellowship or scholarship, with a preference expressed for 'founder's kin'...was a common provision in ancient foundations, although at Oxford and Cambridge they were mainly abolished by Acts of 1854 and 1856.").

379. See HENRY HANSMANN, *THE OWNERSHIP OF ENTERPRISE* 185-86, 190-91 (1996). A private study of university endowments over the period 1961-1989 concluded that "endowment growth roughly equaled net investment returns, while spending and gifts were equivalent positive and negative factors, each canceling out the other." DANIEL A. WINGERD ET AL., *THE GROWTH OF COLLEGE ENDOWMENTS, 1960-1990*, at 7-4 (Common Fund 1993). This study fails to discuss how tuition—which has risen so fast in the last decade—fits into the picture. Evidently, in the aggregate, the returns on endowment produced only bigger endowments, with no current financial benefit to the higher education subsector.

380. I COMMISSION ON PRIVATE PHILANTHROPY AND PUBLIC NEEDS, *RESEARCH PAPERS 28-30* (1977) (the Filer Commission).

381. Cf. KENNY, *supra* note 15, at 66-67 (Lord Hardwicke, during Parliament's debate over the Mortmain Law of 1736, had prepared a speech that would have "warned the lords spiritual to consider the security of their 'eminent, well-endowed dignities,' and

tax-exempt sector. For example, a 1991 Executive Briefing Paper prepared by the National Association of College and University Business Officers warns:

Concern is rising on Capitol Hill regarding the propriety of nonprofit organizations taking part in large and risky business ventures such as the much-publicized buy-out of R.J.R. Nabisco. Five major colleges and universities, as well as the TIAA/CREF (the nation's largest pension fund) were among the 70 investors in this venture.³⁸²

Indeed, T.I.A.A./C.R.E.F. (the Teachers Insurance and Annuity Association—College Retirement Equities Fund)—which enjoyed tax exemption as a charity since its creation in 1918 by Andrew Carnegie—just lost its coveted 501(c)(3) status, despite the opposition of Senator Daniel Patrick Moynihan.³⁸³ More generally, from time to time, Congress has considered adopting a securities transaction excise tax on exempt organizations, ostensibly to curb short-term trading by pension funds and charitable endowments.

Professor John Simon, contemplating the consequences of the Buck Trust case, cautions:

It is not easy to maintain a favorable climate for such philanthropic and legislative assistance without public confidence in the fairness and equity of the philanthropy system.... Another season of public or legislative hostility is not out of the question for the charitable community, particularly if trustees are prevented from taking what is essentially a form of philanthropic self-regulation to cope with bizarre situations like this one. The perception of an adventitious windfall, from the Buck Trust, that lets the "rich get richer"—and that philanthropic mechanisms can do nothing to correct—could contribute to the apprehension that philanthropy, despite the tax

'fortify the enjoyment of what they have' by refusing to receive more; lest their wealth should reach a pitch that would tempt some enterprising prince to repeat the spoliation of Henry VIII's time.").

382. NACUBO EXECUTIVE BRIEFING PAPER: GOVERNMENT POLICY AND REGULATION 17 (1991). Inspired by the R.J.R. Nabisco transaction, the Revenue Reconciliation Act of 1989 splits "high-yield discount obligations" into a debt portion and an equity portion, and denies a deduction for "earnings stripping" payments made to a related tax-exempt person. I.R.C. § 163(e)(5), (j) (1994).

383. Taxpayer Relief Act of 1997, Pub. L. No. 105-34, sec. 1042 (1997) (repealing, effective for taxable years beginning after December 31, 1997, a special grandfather rule in the Tax Reform Act of 1986 that shielded T.I.A.A./C.R.E.F. from new Internal Revenue Code § 501(m) (in which the 1986 Act repealed section 501(c)(3) exemption for organizations that provide commercial-type insurance)); *see also* Gregg Hitt, *Archer, Targeting Professors' Break, Forgets Moynihan*, WALL ST. J., June 27, 1997, at A16 ("From his perch as the top-ranking Democrat on the Senate Finance Committee, Mr. Moynihan vows to protect the New York-based teachers' fund. The senator, a former Harvard University Professor, literally has a vested interest: He is a vested beneficiary of the fund's pension system.").

"subsidy" it enjoys from the public at large, is an avenue to "welfare for the rich."³⁸⁴

CONCLUSION

This Article suggests that the taste for perpetual charitable endowments persists as the happy coincidence of donors' desires for immortality for themselves and for their cultural beliefs, the professional staff's desire for employment and authority, and society's (apparent) desire for narrowly-controlled investment capital.

This "explanation" does not, in the end, serve to justify charitable endowments. It is foolish to think that a particular institution will endure forever; despite centuries-old fears of the power of compound interest, fortunes decay as well as grow.³⁸⁵ It is hubris to think that a particular institution should endure forever. It is inefficient to think that there is no better way to spend the money now, and that no other sources of revenue will arise in future generations to finance the institution. Finally, the nonwealthy who respond to appeals to give small amounts to endowment probably act out of a desire to belong to the group rather than out of an understanding of how the organization spends its funds.

It would, however, be just as foolish and inefficient to require charities to liquidate their current endowments. If we believe that charitable endowments are undesirable, the tax laws could be amended to require charities to develop concrete plans to increase current spending, or else lose tax benefits to those charities that are doing their good works now. Moreover, society might be better served by examining the various outputs produced by *both* the nonprofit sector and the proprietary sector, and directing subsidies where appropriate, rather than subsidizing nonprofits based on their organizational form.³⁸⁶

In the end, society must believe, as Julius Rosenwald observed, that "[w]isdom, kindness of heart, and good will are not going to die with this generation."³⁸⁷

384. Simon, *supra* note 37, at 663.

385. See SIMES, *supra* note 21, at 97; cf. MARCUS, *supra* note 294, at 353 ("Except in a few cases, dynastic continuity has been a very short-run process.... Yet it has been a powerful ideal, fantasy, and value for professional, managerial, and middle-class people, who have sustained the dynastic ideal even when its human subjects have failed to live up to their promise.").

386. See Evelyn Brody, Making the Subsidy Fit the Times: Reforming the Tax Treatment of Charity (Sept. 2, 1997) (unpublished manuscript, on file with the author).

387. Rosenwald, *Principles*, *supra* note 254, at 126.