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## THE LAW OF PHILANTHROPY IN THE TWENTY-FIRST CENTURY: AN INTRODUCTION TO THE SYMPOSIUM

ANNE-MARIE RHODES\*

American philanthropic organizations are a powerful financial and geopolitical force addressing issues of great moment here and around the world. As their numbers and influence grow, philanthropic organizations are coming under increasing scrutiny from donors and regulators, a consequence of what some call a trust deficit. Donors' families are suing nonprofits to enforce the original donor's intent. Governmental scrutiny, through the Senate Finance Committee or state attorneys general, is raising new issues for the nonprofit sector and for those who think about the role of nonprofit law. Federal, state and local governments are looking at charitable organizations as potential sources of revenue. Internationally, non-governmental organizations exert great influence on a broad range of topics from medical care to election results, and that influence grows each year.

All of this is happening against a backdrop of significant change, a philanthropic world of greater need and fewer available resources. The challenges for the organization are matched by the challenges for the law. The goal of this symposium was to gather legal scholars to discuss these challenges, especially the balancing of private property concerns with the need for public benefit, and to provide a persuasive framework of analysis useful for policy makers, judges and attorneys at the time this area of law is developing.

Governance, tax and donor intent were the three topics chosen for discussion.

### I. GOVERNANCE

Governance questions present some of the most vexing and persistent issues in nonprofit law. Many of the issues discussed in this symposium were identified by keynote speaker Marion Fremont-Smith in the 1960s. A central question in this literature is who should regulate the nonprofits, a question of current importance as the call for greater oversight of nonprof-

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its grows louder. The first three papers deal with versions of this question, providing fresh insights and critical perspective.

Professor Lloyd Mayer's and Brendan Wilson's *Regulating Charities in the 21<sup>st</sup> Century: An Institutional Choice Analysis* addresses the choice of regulator head-on and presents the case for the creation of new state-level agencies to regulate nonprofits. Their conclusion is the result of their institutional choice analysis usefully and clearly presented. They note that governance failures undermine public confidence and trust in nonprofits and increase the call for regulatory oversight. The three current primary regulatory bodies (state, federal and self-regulating) have degrees of existing authority and experience, yet they contend that the current players are inadequate to the goal of better governance. Applying a calculus of authority, rulemaking, enforcement and transitional costs, Mayer and Wilson conclude the creation of new state-level agencies independent from the state attorney general would better serve the goal of better governance. Their work is a helpful review of the existing landscape and a pointed guide for future discussion.

Professor Melanie Leslie's *Helping Nonprofits Police Themselves: What Trust Law Can Teach Us about Conflicts of Interest* views the governance question through the lens of self-regulation and highlights the explicit ongoing problem of conflict of interest or self-dealing in nonprofit boards. Using social science research on group dynamics, Leslie posits that the subculture of a nonprofit's boardroom in conjunction with the current fuzzy conflict of interest standard based on corporate law creates a void of independent fiduciary judgment. Leslie argues that nonprofits would be better served by restructuring the law on this question from one based on corporate law standards to one based on trust law's fiduciary standards. Leslie believes that a clearly expressed rule that forces disclosure of a conflict, that requires a greater benefit to the nonprofit than a market alternative, and that requires explicit approval, would assist boards in dealing with conflicts and in internalizing fiduciary norms. While it is debatable whether trust law fiduciary norms are in fact superior to corporate ones, this article makes an important contribution by proposing a concrete framework for boards to analyze self-dealing and to counterbalance the groupthink dynamic present in many volunteer boards.

Professor Evelyn Brody and John Tyler's *Respecting Foundation and Charity Autonomy: How Public is Private Philanthropy?* challenges the fundamental propriety of state regulation of nonprofits. Arguing from the premise that public involvement in the governance of private philanthropy can have a corrupting impact on philanthropy, they challenge a common

theory underlying the rationale for increasing state regulation: a charity's public purpose and tax-exempt status make the charity's assets public money, forming a legitimate basis for state oversight and regulation. Brody and Tyler discredit three of the easy myths underlying equating public purpose with government oversight. The tax status argument, however, merits their particular attention, and they caution against adopting a prescriptive tax approach. Ultimately, Brody and Tyler demonstrate that the current theory for state regulation of private philanthropy decision making and governance is flawed. They ask for a better articulation of a supportable theory before the state directs private philanthropy as public money.

The final two governance papers spotlight two distinct nonprofit organizational models—hybrids and community foundations—and provide two distinct examples of how nonprofits adapt to financial exigencies. These two papers are on the opposite ends of the arc of time: hybrids are new and unburdened by the past while community foundations have decisional histories to navigate.

Professor Dana Brakman Reiser's *Governing and Financing Blended Enterprise* chronicles the rise of state-sanctioned organizational hybrids, that is, entities that are a blend of nonprofit and for profit models. Beyond the skillful and useful presentation of the law relating to limited liability companies (L3C), the community interest company (CIC), and the "B Corporation," Reiser identifies the central governance concern confronting hybrids. Simply put, to the extent a hybrid is seen as a way to expand financing, there is new emphasis on profit seeking. This sharp departure from a clear and settled tradition creates a tension in mission and raises a core question: how does the entity enforce its dual mission? Reiser cautions that, over time, these new hybrids may find that creeping commercialization to support the charitable mission may ultimately erode that mission.

Professor Mark Sidel's *Recent Developments in Community Foundation Law: The Quest for Endowment Building* presents the stark fiscal reality currently facing one of the oldest and most traditional type of nonprofits—the community foundation. Deep under-capitalization of endowments combined with soaring needs have focused attention on endowment building, especially for the smaller non-elite foundations. Using the recent *Denver Federation v. Wells Fargo Bank* case, Sidel demonstrates how a community foundation's history can create hurdles for the effective and efficient management of funds today. Unlike the new hybrids, some community foundations must work through their histories to achieve control of their endowment. Sidel notes that community foundations' struggle to build their endowments also has a state legislative front, often in the

form of state tax credits or allocations of gambling revenues. Sidel unapologetically supports the newfound vigor of the non-elite community foundations in actively seeking control of their endowments and in gaining legislative assistance to grow their endowments through state and local tax incentives.

## II. TAX

For virtually all U.S. philanthropic organizations and causes, achieving and maintaining tax-exempt status is of significant importance. It enhances fundraising, allows more funds to be used for the charitable purpose and serves as an imprimatur of legitimacy. The tax rules governing charitable giving and charitable organizations are traceable almost to the beginning of the current federal tax system and over time have become increasingly complex as abuses have unfolded. The first two tax papers reflect this “working out” of tax rules, the first in the historic context of charitable giving with split interests gifts and the second in the new context of charitable organizations exploring cause-related marketing. The final tax paper takes a different tack, questioning the continued legitimacy of an unlimited estate tax charitable deduction and perpetual private foundations.

Professor Wendy Gerzog’s *The Times Are Not A-Changin’: Reforming the Charitable Split-Interest Rules (Again)* authoritatively chronicles the charitable split interest rules emanating from the landmark 1969 tax reforms and critically examines how these rules have spawned new opportunities for a mismatch between a donor’s deduction and a charity’s benefit. Gerzog points out that much of the unintended tax benefits occurring to sophisticated donors arise from the required use of actuarial tables at the time of the creation of the trust to value the charitable portion of the trust. Actuarial tables by their nature are based on the law of averages, but Gerzog points out that sophisticated donors rarely match an average profile and that, by choosing the time of the gift, type of trust and the property contributed, a sophisticated donor can magnify these benefits. She concludes that definitional changes to charitable split interests need to be made by Congress in order to re-center the connection between a donor’s deduction and a charity’s benefit.

Professor Terri Lynn Helge’s *The Taxation of Cause-Related Marketing* examines a contemporary issue of financial importance: the \$1 billion a year industry of cause-related marketing, in which a for-profit enterprise associates with a charity to promote its business product or service. Like Reiser’s observations on hybrids, Helge notes this blending of for-profit and not-for-profit creates fundamental tensions, here examined uniquely

from the academic tax perspective. Helge persuasively documents the tax uncertainty for the charity generated by cause-related marketing and also acknowledges a more global concern that consumers may be harmed or misled by such marketing. Helge develops two key tax areas: first, the unrelated business income tax and second, the private benefit doctrine. She provides a template for wished for guidance from the Service in the form of a safe harbor for treating the charity's revenue from cause-related marketing as royalty income (and thus not UBTI) and also addressing private benefit doctrine. In doing so, Helge moves the discussion in a useful, concrete and productive manner.

Professor Ray Madoff's *What Leona Helmsley Can Teach Us about the Charitable Deduction* challenges the status quo of the unlimited estate tax charitable deduction and the perpetual trust. Madoff uses Leona Helmsley's estate and its multi-billion dollar charitable bequest for dogs as the springboard to assert the fiscal inequity and social unfairness of the unlimited estate tax charitable deduction and perpetual private foundations. While conspicuously not advocating a particular amount limitation for the estate tax charitable deduction nor time duration for a charitable trust, Madoff argues that federal tax policy and charitable trusts need clearly defined amount and term limits in order to ensure that public charitable purposes are served and not just the donor's private aims for immortality nor trustees' desire for fees and status. It is a call to rethink the fiscal and social consequences of an unlimited charitable deduction.

### III. DONOR INTENT

Donors' donations are the beginning of philanthropy. Donors choose the amount and the cause to support, and usually without restriction. When a donor places a restriction, a condition or specific purpose for the gift, how does the law address assertions that the donor's intent is not being honored? How does the law balance respect for the donor's intent with the needs of the charity? The final two papers address these concerns. The first focuses on the harsh realities of drafting and enforcing a donor's intent. The final paper raises the novel question of the donor's assignability of charitable trust enforcement rights.

Professor Susan N. Gary's *The Problems with Donor Intent: Interpretation, Enforcement, and Doing the Right Thing* authoritatively presents a logical four-prong approach to thinking about the broad issue of donor intent. Beginning with the legal rules centering on historic obedience, Gary notes that the charity's organizational format is less of a concern today as charitable trust principles seem also to infuse charitable corporations, with

certain notable exceptions. She then identifies the two primary reasons why donor's intent may be difficult to ascertain: changing circumstances over time and, pointedly, that the intent may not be incorporated in the legal documents. The obvious responses then are to have only short-term restrictions and to "pin it down" in the document. She concludes with three well-reasoned suggestions for drafting. First have a clear statement of intent. Second, introduce flexibility, perhaps with a direction to consult with family members. Finally, address enforcement, suggesting the technique of having the charity agree not to contest standing, as standing is a judicial issue. Gary's article is a masterful presentation of the realities of litigating donor's intent, framed against the historic and developing rules of obedience, the impact of changing circumstances and forward-thinking concepts for enforcement, enlivened by five recent high profile cases.

Professor Joshua C. Tate's *Should Charitable Trust Enforcement Rights Be Assignable?* examines the fundamental question of who has standing to monitor a charitable trust. He highlights section 405(c) of the Uniform Trust Code that specifically grants standing to "the settlor of a charitable trust, among others." Tate welcomes the addition of settlor standing as the traditional approach of granting standing to a public official—usually the attorney general—is largely ineffective. Tate uses the highly intriguing words "among others" to develop a judicial framework for a settlor's assignability of standing based largely on Langbein's contractarian theory of trusts with additional support from traditional principles of donative transfers. Like Gary, Tate is aware that the passage of time poses the most significant challenge to respecting and enforcing donor's intent. His proposal for a settlor's post-mortem assignment, or alternatively a self-perpetuating trust protector model, is a new and sound response to a significant problem.

#### COMMENTATORS AND KEYNOTE SPEAKER

In addition to the papers provided in this issue, the symposium was well served by four insightful and energetic commentators. The time-consuming role of the commentator is to frame the papers' central theses with clarity and precision, offer concrete suggestions and provide thematic context. Professors Harvey Dale and John Colombo were the commentators for the opening panel on governance. Dean David Brennen was the commentator for the afternoon panel on tax, and Professor Nancy McLaughlin was the commentator for the final panel on donor's intent. All performed masterfully and efficiently in the limited time allotted to them. The speakers' papers benefited from their comments.

Marion Fremont-Smith, widely acknowledged as one of the country's most distinguished experts on the law of nonprofit organizations, was the guest of honor at the symposium lunch. Her remarks provided an expert retrospective on issues that continue to bedevil nonprofit law with suggestions for achievable reform.

#### GRATITUDE

No symposium involves only the presenters and the commentators. The behind the scenes efforts of many are critical for a successful symposium. I thank all who worked so well to bring the day and these law review issues from thought to reality.

This symposium owes particular thanks to three groups. First is the entire staff of the *Chicago-Kent Law Review*, especially Editor-in-Chief David Freedman and Managing Editor Ilana Bamberger, for their sustained and positive effort over an extended period of time. Second is the ACTEC Foundation for its significant financial support and encouragement, with particular thanks to Howard "Scott" McCue as chair of the grant-making committee. Final thanks belongs to the Legal Education Committee of ACTEC as the organizing agent for this third in a series of academic trust and estate symposia.





# I. GOVERNANCE

