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## Non-Profit Types, Uses, and Abuses: 1970

Howard L. Oleck\*

THE POWER, WEALTH, AND NUMBERS of non-profit organizations in the United States, and their impact on our society, are known, and understood, by very few Americans (including very few lawyers). I have special reason to know their importance, because my book on organizing and operating such organizations is phenomenally successful although I am the first to admit that that book (*Non-Profit Corporations, Organizations and Associations*) makes no pretense to be exhaustive or profound.<sup>1</sup> The vast literature on business corporations barely mentions the non-profit ones, and though the *Directory of Law Teachers*<sup>2</sup> in its listing of teachers of *Corporations* adds in small type "Includes Non-Profit Organizations," very few law teachers do teach the latter subject, or even mention it. Only a very few law schools teach the subject regularly; most schools never have offered it.<sup>3</sup> This is both surprising and serious, in view of the relative importance of non-profit organizations in American society; they numbering one out of every three corporations in the nation, for example.<sup>4</sup>

If you open the "Yellow Pages" part of your hometown telephone directory you will be astonished if you add up the number of listings under the classification headings which indicate non-profit character or charitable character. For example, look at "Associations," "Clubs,"

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[Note: This is an updated revision of the paper which Professor Oleck presented at the Seminar on Non-Profit Organizations in 1969, at the Michigan Institute of Continuing Legal Education, at the University of Michigan. He served as Consultant to that Seminar in the planning and staffing of it, as Lead-Off Speaker, and as Concluding Question and Answer "Emcee" together with Prof. John W. Reed, Director of the Institute.]

<sup>1</sup> Oleck, *Non-Profit Corporations, Organizations & Associations* (2d ed., 1965, Prentice-Hall Inc., Englewood Cliffs, N.J.; \$20.00) sells thousands of copies each year, since the first edition appeared in 1956. [Note: Some portions of this paper are extracts from this book.]

<sup>2</sup> Prepared by the Association of American Law Schools and printed and distributed to law teachers by West Publ. Co., St. Paul, Minn. Copies available for sale at the office of the Executive Director of A.A.L.S., One Dupont Circle, N.W., Washington, D.C., 20036.

<sup>3</sup> It is taught fairly regularly at Cleveland State University, Cleveland-Marshall College of Law, by the writer of this article, since he introduced it (apparently, a first in legal education) some 8 or 9 years ago. It also is regularly taught at Syracuse University Law School by Prof. James K. Weeks (formerly of C.S.U. College of Law), who uses a mimeographed *Casebook on Non-Profit Organizations* which he compiled himself. Prof. Marcus Schoenfeld of Villanova Univ. Law School also emphasizes the subject in his courses on Taxation; he also being formerly of C.S.U. College of Law, and the contributor of the tax chapters in Prof. Oleck's text cited *supra*, n. 1.

<sup>4</sup> See below, after n. 6, statistics for Ohio (typical), given in 1969 by the Ohio Secy. of State's Office, Corporation Division.

“Fraternal Orders,” “Labor Unions,” “Schools and Colleges,” “Churches,” “Charities,” “Chambers of Commerce,” or etc. The great numbers of such organizations, especially in major cities, are almost unbelievable.

American society long has consisted, to an extraordinary extent, of voluntary associations of persons and organizations not-for-profit, but for the public good (*pro bono publico*). No other nation in the world even approaches the United States in number and activity of non-profit organizations. These organizations are based on the characteristic American tendency to form groups (to associate themselves) voluntarily, for the accomplishment of social, religious, educational, fraternal, economic, and other purposes. Americans are the greatest “joiners” in the world. American non-profit organizations, generally speaking, are a magnificent part of the society, despite the disturbing growth of abuses among them.

It is fashionable, in some circles, to scoff at the phenomenon of American “societies and groups.” Those who scoff, whether they realize it or not, are scoffing at the very essence of democracy—self-government by free men and women, and voluntary association, voluntary work, and generous contributions for the good of all. But in recent years a serious threat to the nation has developed, in this connection, as *utilization* of non-profit (and tax-exempt) status has increased at an explosive rate—*e.g.*, for example, from 240 foundations in the 1930’s, to at least 30,000 in 1969 (see, below, text at notes 78-85); an increase that taxes one’s faith in the unselfishness of such an explosion of human charitable-ness. A recent study of American swindling says: “. . . Promotion of some national charity or church or community welfare project . . . forms the base on which this country’s most extraordinary rackets build (‘nonprofit’ and tax free) monolithic empires.”<sup>4a</sup>

Nobody knows the exact number of non-profit organizations in this country. No doubt there are hundreds of thousands. And almost every American belongs to, or works in or with, dozens of them in his lifetime.

Merely by way of illustration, a few sample figures (compiled in 1967 in some cases) are stated here; all are from the 1969 or 1970 *World Almanac* and 1970 *Information Please Almanac*:<sup>5</sup>

251 national *religious bodies* reporting (with 321,079 *churches*, plus other component organizations) have 126 million members.

*The American Legion* (posts in almost all cities) has 2.5 million members, plus almost one million in the Auxiliary.

*The American Automobile Association* (branches in almost all cities) has almost eleven million members.

<sup>4a</sup> Hancock & Chafetz, *The Compleat Swindler* 225 (Macmillan Co., N.Y., 1968).

<sup>5</sup> *The World Almanac* 1969 and 1970, and *Book of Facts*, 219, 762; *et passim* (New York: Doubleday & Co., 1969); 1970 *Information Please Almanac*, 446; *et passim* (New York: Dan Golenpaul Associates, Nov. 1969).

The *Girl Scouts* of the U.S.A. (branches in almost all cities) has 3.8 million members.

The *Masonic Order's* many branches ("lodges") have almost two million members.

A *typical college fraternity* (Phi Delta Theta) has over 119,000 members. A *typical professional fraternity* (law) (Phi Alpha Delta) has over 55,000 members. A *typical engineering fraternity* (Tau Beta Pi) has 150,000 members.

In 1967 American *colleges and universities* had an enrollment of almost seven million *students* (4.8 million in public, and 2.1 million in private colleges); over seven and a half million in 1968.

Assets of several *foundations* were: Ford (3.6 billion dollars), Carnegie (320 million), Rockefeller (854 million). In 1969 the Internal Revenue Service reported 30,000 foundations filing reports. There quite possibly are *double* that number, in fact, *acting* as foundations, without bothering to report to anyone. Prior to the Tax Reform Act of 1969 an organization was tax exempt if it met the requirements of the I.R.C., even if it had not obtained a letter of exemption from the I.R.S. Now, a new or existing exempt organization "should" notify the I.R.S. that it considers itself to be a public charity; and if it does not do so it may be subject to some restrictions as a private foundation.<sup>5a</sup>

Non-Profit *Blue Cross* plans enrolled 10.9 million persons in New York, 5 million in Michigan, 5.2 million in Ohio, and 6.1 million in Pennsylvania in January, 1969.

Membership in some typical *labor unions* in 1969<sup>6</sup> was: Teamsters (1.7 million), Automobile (1.4 million), Carpenters (700,000), Machinists (816,000), Steelworkers (1 million).

Non-profit *corporation charters on file* in Ohio totalled about 70,000 in mid-1969, as against 150,000 business corporations, while 4,000 new non-profit articles of incorporation were filed in 1968 as compared with 12,000 new business incorporations. Since 1852 over 420,000 non-profit charters have been filed in Ohio. These figures were provided to me by Mr. Cliff Smucker of the Office of the Secretary of State of Ohio in June, 1969.

A 1949 survey<sup>7</sup> concerned only with "lobbying" and "pressure groups" found in the United States approximately

8,000 trade associations (in 1960 the U.S. Chamber of Commerce reported that there were over 1,200 *national* trade associations—with unstated numbers of local groupings).

<sup>5a</sup> See, "Challenge and Response," a pamphlet published by The Cleveland Foundation et al. (Feb. 1970), at p. 13.

<sup>6</sup> *Ibid.*, 144 (1969 World Almanac); and 181 (Info. Please figures as of 1966).

<sup>7</sup> McDean, *Party and Pressure Politics* 430 (1949).

30,500 agricultural associations.  
 50,000 women's organizations.  
 500 professional associations.<sup>8</sup>

What the numbers are today can only be conjectured, despite "lobby registration" requirements. This is not intended to imply any conclusion as to lobbying and pressure groups. Some Congressmen have declared them essential to the American system of government.<sup>9</sup> Whether or not lobby expenditures and income, as published in the *Congressional Record* in some cases are full or true disclosures, is to be wondered. Also, I do not know who, if anyone, checks up on the reports.

For listing national associations alone, the directory published by the United States Department of Commerce in 1949 required 634 pages.<sup>10</sup> Today's huge, two volume *Encyclopedia of Associations* (current ed., Detroit, Mich.; Gale Research Co.) consists of the Geographic—Executive Volume I of about 1,500 big pages, and Volume II of smaller bulk. The I.R.S. (Treasury Dept.) Cumulative List, published periodically to show organizations in which gifts get tax exemption, is a big, closely printed book, too.

This characteristic American tendency to join voluntary associations was remarked in the 1830's by the wonderful Alexis de Tocqueville. In his penetrating book, *La Démocratie en Amérique*, he said that Americans combine great individualism with "an attitude towards community action that knows no counterpart in the world."<sup>11</sup> For example, by the year 1900 an estimated five million members belonged to over 70,000 local fraternal lodges.<sup>12</sup> What the number is today can only be conjectured, in this era of affluence and widespread leisure for most people.

A cynical recent study said that charity is "the nation's fourth largest industry! In round figures (every year) \$11,000,000,000 will be taken from many pockets and put in a few—all in the name of sweet charity."<sup>13</sup> It uses "52 million volunteers collecting \$11 billion from 187 million Americans for 230,000 philanthropic causes."<sup>14</sup> Los Angeles, for example, in 1967 had 7000 *charity* (not merely non-profit) organizations.<sup>15</sup>

<sup>8</sup> See also, Bone, *American Politics and the Party System* 242 (1949); Key, *Politics, Parties and Pressure Groups* 178 (2d ed., 1948).

<sup>9</sup> E.g., Senator Kefauver, quoted in, Binkley & Moos, *A Grammar of American Politics* 466 (1951).

<sup>10</sup> Judkins, *National Associations of the United States* (Washington, D.C.; U.S. Dept. of Commerce, Office of Domestic Commerce, 1949), published by the Govt. Printing Office (price \$3.75).

<sup>11</sup> Alexis de Tocqueville, *Democracy in America* 196 (Phillips Bradely, ed. 1948).

<sup>12</sup> Schlesinger, "Biography of a Nation of Joiners," 50 *Amer. Hist. Rev.* 1 (1944).

<sup>13</sup> Hancock & Chafetz, *op. cit. supra*, at 225.

<sup>14</sup> *Ibid.*, p. 232.

<sup>15</sup> *Id.*, p. 226.

## Definitions of Non-Profit and of Charitable

Non-profit organizations are those that are not intended to, and do not, produce monetary gain for their members or managers, except as reasonable salaries paid for services as employees, actually rendered to the organizations.<sup>16</sup> Financial gain accruing to an organization from its operation, however, does not make it a profit or business organization if such gain is devoted to its maintenance or improvement.<sup>17</sup> Sometimes the term *not-for-profit* is used as a synonym for non-profit; and sometimes (notably in the new New York statute which is effective as of September 1, 1970) the term not-for-profit is supposed to have some kind of half-mystical, semantically different meaning from *non-profit*.<sup>18</sup> Indeed, the new New York statute is titled the "Not-For-Profit Corporation Law,"<sup>19</sup> and is supposed to be cited as "N-PCL," according to that statute.<sup>20</sup>

Profit, of course, means gain from a transaction or operation. More precisely, it means the excess of income over expenditure in an enterprise, during a given period.<sup>21</sup> In a corporation, the usual test of whether or not it is non-profit is whether or not *dividends* or other equivalent "divvy-up" pecuniary benefits are distributed among its members.<sup>22</sup>

The Michigan statute on non-profit corporations, for example, simply says that a non-profit corporation is one incorporated "for the purpose of carrying out any lawful purpose or object not involving pecuniary gain or profit for its members or associates."<sup>23</sup> Another statutory defini-

<sup>16</sup> Central Credit Union v. Comptroller, 243 Md. 175, 220 A. 2d 568, 570 (1966); Shaker Medical Center Hospital v. Blue Cross of Northeast Ohio, 115 Ohio App. 497, 183 N.E. 2d 628, 631 (1962); Fulmer v. U.S., 133 F. Supp. 775, 788 (D.C. Neb., 1955); Santee Club v. White, 87 F. 2d 5, 7 (1st Cir. 1936); Note, Non-profit Corporation—Definition, 17 Vand. L. Rev. 336 (1963).

<sup>17</sup> As to "charitable," see, Anno., Charitable Gift . . . , 25 A.L.R. 3rd 736 (1969); and see, Greisman v. Newcomb Hospital, 76 N.J. Super, 149, 183 A. 2d 878, 882 (1962); Debs Memorial Radio Fund v. C.I.R., 148 F. 2d 948, 951 (2d Cir. 1945); Burton Potter Post No. 185, Amer. Legion v. Epstein, 219 N.Y. Supp. 2d 224 (1961); Note, Preventing the Operation of Untaxed Business by Tax-Exempt Organizations, 32 U. Chi. L. Rev. 581 (1965); Symposium on Non-profit Orgns'. Problems, 14 Clev.-Mar. L. Rev. 203-299 (1965).

<sup>18</sup> N.Y. Senate Bill No. 956-A, entitled "An Act in relation to not-for-profit corporations, constituting chapter thirty-five of the consolidated laws, and repealing the membership corporations law" (Chapter 1066); and Senate Bill No. 1067, etc.; signed into law by Gov. Nelson A. Rockefeller on May 26, 1969.

<sup>19</sup> *Ibid.*, Sec. 1; and in Sec. 101 (5), (10).

<sup>20</sup> *Id.*, Sec. 101, Short title.

<sup>21</sup> Gifford v. Gabbard, 305 S.W. 2d 668, 671 (Tex. Civ. App., 1957); Citizens National Bank v. Corl, 225 N.C. 96, 33 S.E. 2d 613, 616 (1945).

<sup>22</sup> Associated Hospital Service, Inc. v. City of Milwaukee, 13 Wis. 2d 447, 109 N.W. 2d 271, 280 (1961).

<sup>23</sup> Mich. Comp. L. Anno. Sec. 450.117.

tion, much more precise than that of Michigan, is found in the Ohio Revised Code,<sup>24</sup> which provides that a "merely":

(C) "non-profit corporation" means a corporation which is not formed for the pecuniary gain or profit of, and whose net earnings or any part thereof are not distributable to, its members, trustees, officers, or other private persons; provided, however, that the payment of reasonable compensation for services rendered and the distribution of assets on dissolution as permitted by section 1702.49 of the (Ohio) Revised Code shall not be deemed pecuniary gain or profit or distribution of earnings;

(D) "Charitable corporation" means a corporation organized and operated exclusively for religious, charitable, scientific, testing for public safety, literary, or educational purposes, or for the prevention of cruelty to children or animals;

Notable in this statutory provision is the distinction, by definition, between a corporation that is organized and operated *merely not for profit* (i.e., such as a private golf club; which often is as charitable as Genghis Khan), and a truly *charitable* corporation (i.e., such as a private orphan asylum maintained by contributions from private citizens).

"Private Foundation" (defined below) excludes the so-called "thirty percent organizations," which are those that are exempt from income tax, under I.R.S. Code Section 501(c)(3) because they are "publicly supported" and qualified for charitable contribution deductions, in that at least one third of their (or their parent organization's) income comes from public support, and less than a third from investment income; and "public safety" organizations.<sup>24a</sup>

Few state laws make any serious effort to define accurately the term non-profit. There is no uniform method of reporting by such organizations, either, desirable as such state rules would be; though copies of reports now will be supposed to be sent to state authorities, under the Tax Reform Act of 1969. In most cases, the so-called definitions in statutes simply suggest the non-profit idea in general terms. But then one must take note that statutes governing non-profit organizations are fragmentary and inadequate in many states, and almost non-existent in some. Thus, statutes requiring registration and regular reporting by such privileged (e.g., tax-exempt) organizations are fairly strong in 18 states, rather weak in 12 states, and practically non-existent in the rest

<sup>24</sup> Ohio Rev. Code, Sec. 1702.01 (C), (D). And for similar statutory definition of non-profit see, La. Rev. Stat. tit. 12, Sec. 101 (8) (1948); Wis. Stat., Nonprofit Corp. L., c. 181.01-76 (1953); West's Anno. Cal. Corp. Code, tit. 1, div. 2, art. 1, Sec. 9200 (1947, amend. 1949); Smith-Hurd Ill. Anno. Stat., c. 32 Sec. 163a 1 (c) (1943, amend. 1951).

<sup>24a</sup> See, "Challenge and Response," a pamphlet published by The Cleveland Foundation et al. (Feb. 1970), at p. 3.

of the states.<sup>25</sup> The effect of the registration, publication, and supervision rules of the Tax Reform Act adopted in late 1969<sup>26</sup> is yet to be seen, and will be in the hands of I.R.S. agents who rarely will be such skilled combinations of corporation, tax, administrative, trust, accounting, and other law expertise as can penetrate skillfully masked operations. Indeed, the new tax law now often is sarcastically referred to by some people as "The Lawyers' and Accountants' Relief Act of 1969."

### Motive as Test of Status

When ethical, moral, or social motives are the clearly dominant ones in an enterprise, that enterprise is non-profit. Obviously, it is difficult to test for human motives in an enterprise. Abuse of non-profit status, however, often is best tested by testing the motives of the organizers or officers of non-profit organizations.

The status in our society of non-profit enterprises and organizations very definitely is a privileged one. In recognition of services rendered to us without profit, our communities reciprocate by granting full or partial exemption from taxation, special postage rates, eminent domain powers (*e.g.*, to colleges, in Ohio), exemption from collective bargaining with labor unions or from contributing to unemployment compensation funds, for some organizations in some states (*e.g.*, as to hospitals and homes for the aged, in Ohio), tort immunity that still continues in many states, and other special privileges. We have, in conferring these privileges, developed a complex set of laws and customs.<sup>27</sup>

If an enterprise is to be viewed as non-profit, it is not enough that it merely subordinate the profit motive. It must eliminate profit-making from its basic purposes. This is still the rule in most states, although the astonishing new New York statute<sup>28</sup> seems to take a different view which is set forth and discussed below.

It is not necessary that profit be eliminated from all *activities* of an

<sup>25</sup> Personal report by Richard E. Friedman of Chicago, Ill., former First Asst. Atty-Gen. of Illinois, and draftsman of the Illinois law on Registration of Charitable Trusts; at Mich. C.L.E. Seminar on Non-Profit Orgns., at U. of Mich. on Aug. 22, 23, 1969.

<sup>26</sup> *N.Y. Times*, p. 1 (Jan. 2, 1970).

<sup>27</sup> See, Oleck, *Foundations Used as Business Devices*, 9 *Clev.-Mar. L. Rev.* 339-350 (1960); Note, *Non-profit Corporations—Definition*, 17 *Vand. L. Rev.* 336 (1963); Cary & Bright, *The Law and Lore of Endowment Funds: Report to the Ford Foundation* (pamphlet; 82 pp.; Ford Foundation, N.Y., N.Y., 1969). As to exemption from collective bargaining, see, 29 U.S.C.A., Sec. 152 (2); and Billington, *Hospitals, Unions, & Strikes*, 18 *Clev.-Mar. L. Rev.* 70 (1969) citing cases and statutes; and, *Carmelite Sisters v. Board*, 247 N.E. 2d 477 (Ohio 1969). As to recent developments in tort immunity, see the two cases (*Abernathy*, and *Garnier* cases) in 446 S.W. 2d 599, 607 (Mo. 1969). And see, *Surrey, Tax Incentives as a Device for Implementing Government Policy*, 83 *Harv. L. Rev.* 705 (Feb. 1970). As to income tax exemption see, in this Symposium, the article by Schoenfeld; and as to state property tax exemption the article by Sierk and also the case of *In re Application for Tax Exemption of Dana W. Morey Foundation*, 21 *Ohio App. 2d* 230 (1970).

<sup>28</sup> See *supra*, n. 18.



organization for it to achieve non-profit status. Its practical operation often requires investment of its assets for profit. Incidental acquisition of profits does not destroy its non-profit character if its basic purpose is public benefit, and if its profits are devoted to that purpose.

It follows that non-profit status depends on what is *done* by an enterprise or organization with its income. If this is distributed to persons active in the enterprise, as gains on their *investments* of services, money, or property (*i.e.*, as *dividends*), the purpose is profit.<sup>29</sup> If income is employed solely to further its moral or ethical purpose, the enterprise qualifies for non-profit status.<sup>30</sup>

### Self-Designation as Test of Status

Self-designating or self-describing statements do not suffice to obtain non-profit status and its benefits. The fact that a corporation or association styles itself as a non-profit organization does not make it one.

For example, in an Ohio case,<sup>31</sup> a corporation had stated in its charter that its purpose was to "promote the social welfare of the community," while in fact it was organized as a real estate, home building, "development" operation. The court said that such self-designation was not conclusive when the purpose to act as a housing tract development operation was apparent.

The real tests of non-profit character are in the corporation's activities and methods, in the use or non-use of dividend-bearing capital stock, and especially in whether income is distributed as dividends or profits among the organizers or operators.<sup>32</sup> In this connection, such antique concepts as those of the Michigan statutes which still permit use of stock (as equivalent to certificates of membership) in non-profit organizations, are anachronisms that encourage misconceptions of the real nature of such organizations.<sup>33</sup>

Nonetheless, self-designation is *one* of the test elements in determining non-profit status. For example, in a suit against the University of Georgia Athletic Association, Inc., injunction was sought against that association's operation of a laundry business on the university campus, for cleaning athletic uniforms and equipment. It was objected that the association used state trucks and equipment in a private commercial enterprise.<sup>34</sup> The Georgia court ruled that the association was a non-

<sup>29</sup> Associated Hospital Service case, *supra*, n. 22; Lusk, Uncertain Future of Charitable Trusts, 15 Ala. L. Rev. 390 (1963); Note, Public Charity and Tax Exemptions, 36 Temple L. Q. 198 (1963).

<sup>30</sup> Shaker, Sulmer, and Santee cases, *supra*, n. 13; also, *supra*, n. 24; and see, 1 Oleck, Modern Corporation Law, 550-561 (1965 supp.); and Shefelman, What Is Charitable?—Legal and Tax Limits of Trusts & Estates 654-7 (1952); Wynn, Charitable Organizations, 92 Trusts & Estates 762-6 (1953).

<sup>31</sup> State ex rel. Russell v. Sweeney, 153 Ohio St. 66, 91 N.E. 2d 13 (1950).

<sup>32</sup> Cummins-Collins Foundation, 15 T.C. 613, 622 (1950).

<sup>33</sup> Mich. Comp. L. Anno., Secs. 450.117-450.119.

<sup>34</sup> Westbrook v. Univ. of Ga. Athletic Assn., Inc., 206 Ga. 667, 58 S.E. 2d 428 (1950).

profit organization, and denied the injunction. It rested its decision largely on a provision in the association's charter that the "object of said corporation is not pecuniary gain by its members but is to promote the physical and moral welfare of the student body," because that statement apparently was true.

*Self-designation required.* Self-designation, in its charter, as non-profit, is required of an organization by statute in some states and in some is required by administrative custom. Thus, California's statute requires that the articles of incorporation set forth "The specific and primary purposes for which it is formed."<sup>35</sup> Obviously, the non-profit nature of the corporation must be indicated by the nature of these purposes. The same is true where statutory provisions are even less precise, as in the present Ohio or the old New York statute, which respectively requires (and required) merely a statement of "The purpose or purposes for which it is formed."<sup>36</sup> New Jersey requires only a statement of "The purpose for which it is formed."<sup>37</sup>

Illinois, which (like Michigan) lumps profit and non-profit corporations in the same chapter of its statutes,<sup>38</sup> does not place in the non-profit portion the usual outline of contents of articles of incorporation. Instead, the provision as to purposes of non-profit corporations implies that the statement of purposes must indicate their non-profit nature.<sup>39</sup> Missouri's statute does not provide any requirements for a form of incorporation in its non-profit organization statute, but permits use of articles of agreement, which are recorded in the county and then filed with the secretary of state.<sup>40</sup> Such articles, too, necessarily would declare non-profit purposes.

In practice, all states require that an organization clearly indicate in its articles of incorporation that its purpose or purposes are non-profit. For income tax exemption purposes, it is desirable that the articles clearly indicate charitable rather than merely non-profit purposes, if such be the case. If this is not done, difficulties with the Internal Revenue Service are to be expected when tax exemption is sought.

<sup>35</sup> West's Anno. Cal. Corp. Code, Sec. 9300 (b). See, Note, Permissible Purposes for Nonprofit Corporations, 51 Columbia L. Rev. 889 (1951).

<sup>36</sup> (Until Sept. 1, 1969) N.Y. Consol. L., c. 35; Memb. Corp. L., Sec. 10; and, continuing in Ohio, Ohio Rev. Code, Sec. 1702.04 (A).

<sup>37</sup> N.J. Stat. Anno., tit. 15, Sec. 15: 1-2 (b) (1898, amend. 1946). See, Kerney v. Kehn, 46 N.J. 535, 218 A. 2d 403 (1966).

<sup>38</sup> Smith-Hurd Ill. Anno. Stat., c. 32 (Secs. 1-157.167 are for business corporations; Secs. 158-163 were the old non-profit provisions, now repealed; and Secs. 163a-100 are the non-profit provisions generally).

<sup>39</sup> Smith-Hurd Ill. Anno. Stat., c. 32, Sec. 163a3 (1943, amend. 1961). See, Gale v. York Community Center Coop., Inc., 21 Del. 2d 86, 171 N.E. 2d 30 (1961).

<sup>40</sup> Vernon's Anno. Mo. Stat., c. 352, Sec. 352.060 (1939). See Koprivica v. Bethesda Genl. Hosp., 410 S.W. 2d 84 (Mo. Sup. 1966).

## Main Forms of Non-Profit Organizations

This discussion omits the unusual (odd-ball) types of organizations, such as Michigan's *trustee corporations*,<sup>41</sup> which really seem to be merely one type of incorporated foundations.

*Individual enterprise* often serves non-profit purposes. Individual charitable *contributions* and public-benefit work are allowed, within certain statutory limits, as tax deductions. But, in general, deductions are allowed only for *gifts* to a formally organized entity such as a corporation, association, or trust. Even a contribution to an informal group devoted to aiding servicemen has been disallowed.<sup>42</sup>

Beside tax relief, there is little legislative support for individual philanthropic activity. The little legislation on individual charities aims primarily to keep swindlers from posing as philanthropists. *Licensing of solicitation of contributions* and of *persons who solicit* contributions are the principal checks on such abuse of non-profit status.<sup>43</sup>

*Partnership* for non-profit purposes is actually a contradiction in terms, but the expression does occasionally appear. This is because an ordinary business partnership is (by statutory definition) an association of two or more persons to carry on, as co-owners, a business *for profit*.<sup>44</sup> If the profit element is eliminated, we are left with an association of two or more co-owners to carry on certain activities. That peculiar organization is usually termed an *association*.

The *association* once was the principal form of organization for non-profit purposes. *Association* is a vague term for a group of persons who have joined in a common purpose. Sometimes the word *society* is used in the same sense, but this word is confusing because it also means "a community" or "the public." Many other terms also are used, of course, to convey the idea of a group or association (*e.g., fraternal order, brotherhood, union, etc.*). Ordinarily, an association is not incorporated. If it is, it is more accurately and understandably called a *corporation*, whether its purposes be profit or non-profit.

Unincorporated, an association is a body of persons united in purpose and acting together, usually without a formal charter. Yet, it usually employs the methods and forms used by corporations, and is often

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<sup>41</sup> Mich. Comp. L. Anno., Sec. 450.148 et seq.; and compare *foundations*, under Sec. 450.163 et seq. As to types of organizations generally, see, C.C.H.'s *The Tax Exempt Organization* (1969).

<sup>42</sup> Carolyn Trippe, P-H TC Mem. Dec. ¶ 50,175; C.C.H. ¶ 17,775.

<sup>43</sup> See discussion in, Oleck, *Non-Profit Corps., Orgns. & Assns.*, Sec. 16 (2d ed., 1965), citing various articles and such statutes as those of Calif., Ohio, etc. *E.g.*, see, re a Fort Worth city ordinance, *National Foundation v. City of Fort Worth*, 415 F. 2d 41 (5th Cir. 1969).

<sup>44</sup> See, generally, the Uniform Partnership Act, and, Crane, *Partnership* (rev. ed., 1952).

treated by tax and governmental authorities as a quasi-corporation.<sup>45</sup> This is especially likely if its organization and operation are governed by a written agreement among the members (*e.g.*, *articles of association*).

The *unincorporated association* has many disadvantages and few advantages. Fundamentally, it is not, as the corporation is, a legal entity separate from the persons who control it. Yet, often, if it suits governmental purposes, it is treated as if it were. Also, the laws governing such groups are few, vague, and inadequate to spell out a system of organization and operation. The number of important unincorporated associations has dwindled in recent years, while the number of incorporated associations has multiplied rapidly.

The *corporation* now is by far the best and most popular form of organization for most group enterprises. It combines several advantages: freedom from personal liability, continuity of existence, and great range and scope because of joinder of resources and efforts. Detailed and plentiful legislative, administrative, and executive studies during the past century have produced a wealth of plans for effective organization and operation, at least as far as business organizations are concerned; not so good for non-profit types. Barring some unexpected new form of joint enterprise, the corporate form probably will dominate for some time to come, in both types.

The *corporation* has been defined in many places and ways.<sup>46</sup>

The *foundation* is a relatively modern form providing endowment of a non-profit enterprise and the setting up of a corporation or an association to carry out the originator's plans.<sup>47</sup> Michigan's *trustee corporations*, formed to execute specific written grants, are very similar to the ordinary incorporated foundation; and the special statute<sup>48</sup> governing it seems to be a redundancy.

Some foundations are set up in *charitable trust* form. That is, the grantor of the foundation endowment, by a deed of trust,<sup>49</sup> conveys

<sup>45</sup> See, Webster, *Associations and the I.R.S.* (Chamber of Commerce of U.S., 1966); Rabkin & Johnson, *Federal Income, Gift and Estate Taxation* §§ 2.10-2.12 (rev. to date). As to unincorporated associations in general, see, Wrightington, *Unincorporated Associations and Business Trusts* 285 (1923); Ford, *Unincorporated Non-Profit Associations, Their Property and Their Liability* (1959); Josling & Alexander, *The Law of Clubs* (London, 1964).

<sup>46</sup> See, *Trustees of Dartmouth College v. Woodward*, 4 Wheat (16 U.S.) 518, 629; 4 L. Ed. 629 (1819); *Louis K. Liggett Co. v. Lee*, 288 U.S. 517; 53 S. Ct. 481; 77 L. Ed. 929 (1932), 85 A.L.R. 699 (dissent); Oleck, *Modern Corporation Law*, Sec. 2 (1965 supp.); *Directors' and Officers' Ency. Manual* 136 (New York: Prentice-Hall, Inc., 1955); Nesbitt, *Removal of Voting Power from Members of Non-Profit Orgns.*, 16 *Clev.-Mar. L. Rev.* 384 (1967).

<sup>47</sup> See, Oleck, *op. cit. supra*, n. 1; Fremont-Smith, *Foundations & Government*, 12 (1965); Cary & Bright, *op. cit. supra* n. 27. For a sympathetic short study, see, Calkins, *The Role of the Philanthropic Foundation*, 11 *Foundation News* (1) 1 (Jan.-Feb. 1970).

<sup>48</sup> Mich. Comp. L., Sec. 450.148.

<sup>49</sup> See, *In re Sherman*, 12 F. Supp. 297 (D.C. Va. 1935); *Bank v. Pierce*, 144 Cal. 434, 77 P. 1012 (1904).

money or property to a named trustee or trustees, to be disbursed as directed in that document. This differs from a private trust in that the beneficiaries are not named individuals, but are un-named members of a specified group or class of people or of the public generally.<sup>50</sup> The grantor usually directs that a charitable corporation be formed to serve as the corporate trustee; the corporation itself being governed by a board of its own trustees, who usually are persons named by the grantor. Or, he directs the named trustees to organize a charitable corporation which will become the corporate trustee. Occasionally the unincorporated group of trustees is given the option of incorporating or not incorporating, as they see fit.<sup>51</sup>

The document of incorporation or endowment—say, of a scholarship fund—is the *foundation*.<sup>52</sup> The grantor (an individual or an organization), who usually specifies the purposes for which the fund or the property is to be used, is the *founder*. The organization that is set up is the trustee.<sup>53</sup> In popular usage, foundation may mean the entire enterprise, or (more often) *the organization* that administers the fund itself.

*Other forms of organization.* Now and then, a few other forms of organization or management are used for non-profit purposes, including such varied techniques as *individual trusteeship, committee control, governmental supervision, and bank or insurance company management.*

### Main Classifications of Non-Profit Organizations

In the broadest sense, there are five principal classes of non-profit organizations:

1. *Charitable organizations.* These include religious, educational, hospital, library, and civic organizations, and the like.

2. *Social organizations.* These include clubs, mutual benefit societies, fraternal orders, and the like. Not included are "clubs" such as night clubs, Christmas clubs, limited-editions clubs, or one-man clubs.

<sup>50</sup> Bauer v. Myers, 244 F. 902, 911 (8th Cir. 1917).

<sup>51</sup> See, Oleck, *op. cit. supra* n. 1, at c. 31.

<sup>52</sup> Segrave's Appeal, 125 Penna. 362; 17 A. 412 (1889); Union Baptist Assn. v. Hunn, 7 Tex. Civ. App. 249; 26 S.W. 755 (1894); Raymond Rich & William Harrison, S.M., and F. E. Andrews, American Foundations for Social Welfare (1946); Taylor, E. K., Public Accountability of Foundations and Charitable Trusts (Russell Sage Foundation, 1953); Andrews, F. E., Philanthropic Foundations (Russell Sage Foundation, 1956); Fremont-Smith, Foundations and Government (Russell Sage Foundation, 1965).

<sup>53</sup> Note, Purposes for Which Charitable Trusts May Be Validly Created, 9 Wash. & Lee L. Rev. 310-16 (1952). See, generally, Bogert, Trusts (rev. ed., 1953); Note, Gifts to Charitable Corporations—Nature of Interest Created—Duties of Trustee, 26 So. Calif. L. Rev. 80-86 (1952); Unif. Act for Supervision of Charitable Trusts Report 512 (Natl. Conf. Comm., 1952). See, for many examples, The Foundation Directory, Edition 3 (New York: Russell Sage Foundation, 1967); Reiling, Sham Foundations, Misused Foundations, and Income Taxation, 47 Taxes 394 (1969).

3. *Political* organizations. These include political party organizations, propaganda organizations, and committees to aid the candidacy of a political hopeful or the adoption of certain legislation.

4. *Trade* associations. These include labor unions, boards of trade and chambers of commerce, manufacturers' or employers' associations, and the like.

5. *Governmental* organizations. These include all governmental and municipal organizations, such as municipal corporations (those of cities, towns, villages, counties, and road and water districts), and administrative bodies such as the Civil Aeronautics Board, the Tennessee Valley Authority, the New York Port Authority, and the Commodity Credit Corporation. Most of these are established and operated pursuant to express legislative provisions.

Overlapping of purposes and of the means of accomplishing them is to be expected. Accomplishment of religious purposes, for example, necessarily involves educational activities. Political clubs usually also have social aspects; and so on.

### Statutory Classifications

Statutory classification of non-profit organizations, particularly for corporation-supervision purposes, has been undertaken in several states—notably in Florida, Illinois, Louisiana, New Jersey, New York, Ohio, Pennsylvania, and Wisconsin. The classifications stated in the California Code, applicable to all corporations generally, are typical of the more common, less complete codes. Mixed statutes, such as those of Michigan,<sup>54</sup> are like the California approach, but are even harder to follow.

The California general statute (General Corporation Law) recognizes (1) *Foreign or domestic* corporations,<sup>55</sup> and (2) *Stock or nonstock* corporations.<sup>56</sup>

Today, in most states, no shares of stock are employed in non-profit corporations. Instead *certificates of membership* are issued to members. Even if the certificates used still are called "stock" or "shares," they do not receive dividends. The term *nonstock* is generally understood to be a synonym for non-profit. This is clarified, to some extent, by another section of the California statute, which says:

"Shares" and "shares of stock" include membership in non-stock corporations.<sup>57</sup>

<sup>54</sup> Mich. Comp. L. Anno., Ch. 450.

<sup>55</sup> West's Anno. Cal. Code, Corps. Code, Sec. 106 (1947).

<sup>56</sup> *Ibid.*, Sec. 107 (non-stock).

<sup>57</sup> *Id.*, Sec. 115 (1947).

California also recognizes a special category of Federal Corporations, organized and wholly owned by federal agencies.<sup>58</sup> Besides this, the California non-profit corporations statute divides those organizations into a few general categories.<sup>59</sup>

Ohio's statutory system provides a far more detailed classification.<sup>60</sup> It breaks down the specific kinds of non-profit organizations into the chief actual categories, and provides a chapter of its code for each. This is the so-called *trunk system* of corporation statutes, with general provisions applicable to all corporations, followed by specific chapters applicable to specific types of corporations (e.g., religious, educational, etc.). Ohio's terminology, as often is the case everywhere, is not precise. Thus, it will speak of *Professional Associations* when it means corporation-type groups of doctors or lawyers (for the purpose of qualifying for federal tax benefits available to corporation pension systems and the like).<sup>60a</sup>

Michigan's antiquated system of lumping business and non-profit organizations together in one chapter of its statutes<sup>61</sup> compares poorly with this system.

### General Results of Statutory Classification

Statutory classifications like those set forth above have directly important results. Once a given organization has been classified, it falls under the particular statute or group of statutes governing that class of organization. The classification of an organization largely determines how it must be operated, or dissolved, and especially what supervision it may expect from the public authorities.

For example, considering only the special types, the following governing statutes are found to apply, under the laws of many states: *Social Clubs* must be formed under the *general* non-profit statutes, if incorporated.<sup>62</sup> *Churches* must be formed under the religious or church corporation chapters of the statutes.<sup>63</sup> *Educational organizations* must be formed under the educational corporation statutes if they are to be non-profit,<sup>64</sup> and under the business corporation statutes otherwise.<sup>65</sup> In

<sup>58</sup> *Id.*, Sec. 123 (1947).

<sup>59</sup> *Id.*, Secs. 9000 to 13356 (1953).

<sup>60</sup> Ohio Rev. Code, tit. 17 (1955, amend. to 1969).

<sup>60a</sup> These are intended to make available to professional "partnerships or corporations" the tax and other benefits of corporate form. Such associations have been held to be barred to lawyers in Ohio, on the theory that only the courts may control the form of practice of law. *State v. Brown*, 173 Ohio St. 114, 180 N.E. 2d 157 (1962).

<sup>61</sup> Mich. Comp. L. Anno., Chap. 450.

<sup>62</sup> *E.g.*, under the Ohio Revised Code (tit. 17), Chapter 1702 thereof.

<sup>63</sup> *Ibid.*, c. 1715.

<sup>64</sup> *Id.*, c. 1713.

<sup>65</sup> *Id.*, c. 1701.

either case the statutes usually require compliance with the education laws as to academic standards, faculty, facilities, reports, and the like. *Cooperatives* may be formed under either non-profit<sup>66</sup> or business cooperative statutes, depending on which type is desired, in many states. *Agricultural and horticultural corporations* (such as county-fair organizations) must be formed under specific agricultural corporations statutes in some states,<sup>67</sup> and under the general non-profit statutes in others. *Credit unions* (special quasi-non-profit organizations) must be formed under credit union statutes in some states,<sup>68</sup> and under banking laws in the absence of special statutes. *Urban development* corporations now have several provisions to assist them, in many states.<sup>69</sup> *Fraternal benefit societies* and mutual indemnity organizations are subject to state insurance statutes in most states, and also to benevolent society statutes, both types of statutes being applicable to their organization. *Non-profit medical indemnity plan groups* (such as the Blue Cross) are formed under the insurance statutes in many states, and under special medical care or hospital service statutes in some states.<sup>70</sup> *Municipal corporations* must be formed under village, town, or city corporation statutes (whichever is appropriate), depending primarily on population. While they are non-profit in nature in many respects, they form a category of their own, governed primarily by special municipal law statutes. Similarly, *district corporations*, such as school, road, or water districts, must be organized under special statutes in most states.<sup>71</sup> *Foundations* must be organized under charitable corporations statutes in most states, if they are to be incorporated, or under charitable trust law if not to be incorporated. A few states (such as Michigan) also have charitable trust corporation statutes.<sup>72</sup> *Trade associations* must be organized under special trade association statutes in some states,<sup>73</sup> and under the general non-profit statutes in others.

The above illustrations of some special classes of corporations should suffice to indicate the nature of modern legislation on this subject in most states.

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<sup>66</sup> *Id.*, c. 1729.

<sup>67</sup> *Id.*, c. 1711.

<sup>68</sup> *Id.*, c. 1733.

<sup>69</sup> *Id.*, c. 1724, 1726, 1728.

<sup>70</sup> *Id.*, c. 1737, 1738, 1739, 1740 in Ohio.

<sup>71</sup> *E.g.*, N.Y. Village Corp. Law, etc.

<sup>72</sup> These are mentioned again, below. See also, Foundation Directory, Edition 3, p. 13 (1967).

<sup>73</sup> *E.g.*, Ohio Rev. Code, c. 1725.



## Model Non-Profit Corporation Act Provisions

In 1952 the Committee on Corporate Laws of the Section of Corporation, Banking and Business Law of the American Bar Association published a proposed Model Non-Profit Corporation Act; a general statute, but complete with "official forms." The model statute has aroused little interest, though it has been used in parts in some states.<sup>74</sup> It is very doubtful that a committee dedicated primarily to business and financial organizations is the proper one to develop non-profit and charitable organization structure. Especially where charitable purpose and/or tax exemption are supposed to be present, the ethics and practices of "the market place" are hardly the same ones that are supposed to guide persons seeking public service, religious, or charitable goals—and they certainly should not be permitted to be the same ones, unless our society is to abandon all pretense of altruism (and the privileges granted as rewards therefor) in any of its activities or organizations.

## Special Approvals in Special Classifications of Organizations

In a few states, submission of the proposed charter of a non-profit corporation to a special investigating and supervisory agency (e.g., the New Jersey Department of Institutions and Agencies) is required. New York recently adopted a similar rule. Approval sometimes follows the preliminary filing of the charter with the clerk of the county in which the home office of the organization is to be located,<sup>75</sup> in some states. These general requirements usually apply to all classes of non-profit corporations.

In most states there is no single general approving agency like the New Jersey Department of Institutions and Agencies. Approval by a judge and/or by the attorney-general sometimes is the preliminary general approval.<sup>76</sup> *Additional* approvals by special agencies often are required for certain organizations and activities.<sup>77</sup>

A typical breakdown of special state approving agencies is shown below. Titles of agencies vary from state to state, and equivalent local titles should be substituted in each state. Some state statutes designate private organizations as approving agencies for certain activities. The usual supervisory-approving agencies are typified by the following few examples:

<sup>74</sup> See (revised version), the pamphlet, Model Corporation Acts/Practice Handbook D—Model Nonprofit Corporation Act (1964 revision), ALI-ABA Joint Committee on Continuing Legal Education.

<sup>75</sup> N.J. Rev. Stat. tit. 15 (sections dealing with the Dept. of Institutions and Agencies and with county clerks' functions).

<sup>76</sup> E.g., in New York, for some types of organizations, but not for all after Sept. 1, 1970.

<sup>77</sup> See, for example: Re: Independent Republican Club, 58 N.Y.S. 2d 162 (1945) (political approvals); Re: Gold Star Parents Assn., 67 N.Y.S. 2d 73 (1946) (conflict of names); Re: Long Beach Defense Guards, 100 Misc. 584; 166 N.Y.S. 459 (1917) (paramilitary organization).

*Asylums, homes for abandoned children, etc.:* Department of social welfare.

*Cemetery associations:* Cemetery board or commission, the clerk of the county where the cemetery is to be situated, and the city, town, or village where any part of the cemetery may lie; all three approvals often are required.

*Churches, synagogues and parishes:* Official consent of the bishop, synod, diocese (or equivalent) often is required.

*Clinics or dispensaries:* Department of hospitals, or department of social welfare.

*Colleges or schools:* Superintendent or commissioner of education and/or (in some states) state university, and/or board of regents. Also, for denominational institutions, denominational authorities; or other appropriate agencies, such as the Civil Aeronautics Board for flying schools, State high courts and/or the American Bar Association for accreditation for law schools, etc.

*County professional societies:* State (and sometimes, national) professional societies.

*Cruelty prevention:* State Society for Prevention of Cruelty to Children. The "American Society for Prevention of Cruelty to Animals," despite its name, is a local New York organization. The nearest to a national organization, in this field, seems to be the "National Catholic Society for Animal Welfare, Inc.," which actually is a lay society supported by persons of the Catholic, Protestant, and Jewish faiths.

*Hospital or medical expense groups:* Superintendent of insurance, and department of social welfare; both.

*Labor organizations:* Labor department or board of standards.

*Legal aid society:* State appellate court, and bar associations.

*Libraries:* Department of education, and local (town or city) school or other authorities.

*Military organization-aid groups:* Adjutant General.

*Monuments and memorials:* Public authorities of the city, town, or village, if public property is to be used.

*Political party organizations:* Chairman of county committee of the particular political party. (If he unreasonably withholds his approval, the superior court may order it dispensed with.)

*Trade associations:* Parent association's executive officers, pursuant to the parent constitution or bylaws. Such approval is not required for local or separate associations.

*Worker's organizations:* Labor department, or board of standards.

## Major Special Kinds of Non-Profit Organizations

The main types of non-profit organizations (e.g., fraternal, civic, educational, trade, etc.) have been mentioned above. In addition, recent years have seen certain special kinds of non-profit organizations become highly important and numerous. These merit special mention and brief summaries as to their nature. Some of the major ones are foundations, urban redevelopment corporations, landholding companies, "bootstrapping" organizations (see below), organizations for housing for the elderly, "churches" of exotic purposes, etc.

### Foundations Used as Holding Companies

An important use of foundations today, by too many of them, still is as almost tax-exempt personal holding companies. It is gravely to be doubted that the "self-dealing" prohibitions of the Tax Reform Act of 1969 will cure this. Such a unit is set up with endowment consisting of stock of business corporations controlled by the founder. Control is fastened onto the corporations by the deed of trust that conveys their stock; and it provides (for the founder) gift-tax benefits (deductions), great income and other tax avoidance, perpetuation of control, fine public relations, low cost research and product development, competitive advantage over companies that pay full taxes, ready source of capital, and thus far practically no real governmental regulation. For a "limits-of-the-law" example, see the *Scholler Trust*<sup>78</sup> deed of Trust used as a form in *Oleck, Non-Profit Orgns., etc.*<sup>79</sup> Just how the new self-dealing restrictions of the Tax Reform Act of 1969 will affect such devices is yet to be seen.<sup>79a</sup>

Foundations now still often are spoken of (among legal cognoscente) as "business devices," "straw men" for tax advantage use, and as "venture capital" devices.<sup>80</sup> Congressional investigations of them, in 1961-2 (Patman Committee, to which I was the Consultant), and 1969-70 (Mills Committee), have made a lot of headlines but so far only a few quite

<sup>78</sup> 403 Pa. 97, 169 A. 2d 554 (1961).

<sup>79</sup> (2d ed., 1965), at pp. 75-82; and see Feature Series of Articles, *Cleveland Plain Dealer*, p. 1 (July 9, 1969) and succeeding chapters therein.

<sup>79a</sup> See, Eliasberg, *New Law Threatens Private Foundations: An Analysis of the New Restrictions*, 32 *J. Taxation* (3) 156 (Mar. 1970), for a "management" ("tax advantages desired") view of the new statute.

<sup>80</sup> See, 1 *Oleck*, *Modern Corporation Law*, 533 (1965 supp. ed.); and Vol. 2, at p. 632; and Vol. 3 at p. 520 (1959 with 1965 supp.). As to "straw men," used by oil companies as conduits for holding mineral rights and using depletion allowances for total tax evasion, see, Lang, "Charity" Saves Oilmen Tax Millions, in *Cleveland Plain Dealer* (A.P. story) p. 1 (Nov. 24, 1969) (e.g., one foundation in 1967-8 handled almost \$3 million, and gave \$25 (yes, 25, total) as its charitable distributions.

confusing and uncertain, though hoped-for, reforms.<sup>81</sup> In late 1969, with President Nixon threatening a veto, the Congress had to soft-pedal or drop most of the really vital tax reforms sternly promised not long before that time,<sup>82</sup>—not that some of our statesmen needed much urging to do so.

In the 1930's there were about 240 foundations in this country (6 in Ohio, 58 in New York, etc.).<sup>83</sup> Then, the *Foundation Directory Edition 3* (1967) said there were 6,803 in 1966 (463 in Ohio, 1,822 in New York) as of 1965 figures. It also said there were 18,000, but that 10,000 were "very small" (i.e., assets less than \$200,000 or making grants less than \$10,000 per year). But in 1969 the I.R.S. Official List of tax-free foundations registered with it, numbered 30,262.<sup>84</sup> This latter list shows 1,493 registered in Ohio, while the *Foundation Directory* says 463 (a disparity of 1,030). The current Mills Committee investigation has not yet filed a final report.

The Foundation Library Center's *Foundation Directory* says foundations now own \$19.6 billion in assets. But in early 1969 the New York attorney-general's investigation in *New York alone*, found an "alarming rate" of cases of foundation funds diverted to personal uses, and 1/3 of the 13,500 foundations that had registered there owned \$25 billion in that state alone; and the investigation had not ended yet.<sup>85</sup> He said that in New York alone the number of foundations was increasing at about 100 per month. A recent addition to the few directories available is the *1969 Directory of Charitable Corporations, Foundations and Trusts Registered in Oregon*, published by that State's Department of Justice, in 195 pages, listing 866 organizations.

A "deed of trust" setting up a foundation endowed with business corporation stock may evade the basic principle of corporation statutes and law, that control shall not be taken away from the board of directors. The legal phrase often used is that "the board of directors shall not be sterilized." But in many foundations of this sort, today, we may still find such provisions as the following:<sup>86</sup> "Voting trust" type provisions, ordinarily limited by statutes to a ten year maximum duration, may be perpetual in effect; nor is the "voting trust" open to other stockholders as the law

<sup>81</sup> See, *Ibid.*; and "House Ways & Means Progress Report," in 10 *Foundation News* (4) 139 (July-Aug. 1969).

<sup>82</sup> *Cleveland Plain Dealer*, p. 1 (Sept. 5, 1969).

<sup>83</sup> *Foundation Directory Edition I* (Russell Sage Foundation, N.Y.C., 1939). As to the history of foundations, see, Weaver, *U.S. Foundations*, esp. 14-16 (Harper & Row, N.Y.C., 1967).

<sup>84</sup> U.P. Report, in *U.S. Newspapers* (Jan. 9, 1969). The list book can be had for \$6.50 from the Govt. Printing Office.

<sup>85</sup> *N.Y. Times* (Jan. 18, 1969).

<sup>86</sup> See, Oleck, *Non-Profit Corps., etc., supra*, n. 79.

ordinarily requires. Control of salaries, a major power of corporate directors, is taken from them—a “sterilizing” provision. Control of bonuses and/or profit sharing, a major power of corporate directors, is taken from them—a “sterilizing” provision. “Compulsory” contributions by the corporations to the “foundation,” normally a major management decision for directors, are effectively forced on them—a “sterilizing” provision. Control of stock transfer or sale, a major aspect of directors’ managerial power, is taken from them—a “sterilizing” provision. Domination of corporation management, articles of incorporation, and by-laws, are taken from directors, for the “trust”—a “sterilizing” provision. Power to decide on “unusual” outlays, purchases, debts, investments, and salary increases, all distinctly management powers of directors, are taken from them—a series of “sterilizing” provisions. Control of annual audit and loan powers, which also are inherently directors’ managerial decision, are effectively taken from directors—a “sterilizing” provision. Removal and replacement of directors who dare to independently exercise their lawful management powers, fundamental rights and duties, are taken over by the “trust”—not merely a “sterilizing,” but actually an “emasculating” provision. Control of corporate subsidiaries, a basic power of directors, is taken from them—a “sterilizing” provision.

Such supine submission by the corporations’ respective boards of directors, of course, warrants (but rarely results in) *quo warranto* action by the Secretary of State or Attorney General. How effective the new rules against “self-dealing,” in the Tax Reform Act of 1969, will be in curbing these abuses, is yet to be seen. As long as perpetual life and tiny taxation of only net investment income hold true for foundations (as they do) the temptation towards (and ease of) abuses probably will continue. The new rules, placing a 20% limit on business stock ownership, ignore the facts that 20 percent may suffice for control and that “partnerships” aimed at avoiding the rule are an obvious route for evasion, for example.

In early 1970, atheist Madalyn Murray O’Hair, well known for her opposition to all religion, said in Austin, Texas, that she and her husband, Richard, had organized the “Poor Richard’s . . . Church” for tax evasion purposes. She said, “From here on we’re going to take every exemption.” She and he had received Doctor of Divinity degrees from a California religious organization, she explained.<sup>86a</sup> The church organizing “business” is illustrated with breathtaking frankness by the following advertisement, which appeared in a weekly Cleveland newspaper recently: <sup>86b</sup>

<sup>86a</sup> Cleveland *Plain Dealer*, p. 4 (Jan. 27, 1970).

<sup>86b</sup> *CSU Cauldron* (Vol. 40, No. 11, p. 8) published by the students of Cleveland State University (Jan. 27, 1970) [Names removed by the Editor of this Review].

WOULD YOU LIKE  
TO START  
YOUR OWN CHURCH?

We will furnish you with a Church Charter and you can start your own church. Headquarters of \_\_\_\_\_ CHURCH will keep records of your church and file with the federal government and furnish you a tax exempt status—all you have to do is report your activities to headquarters four times a year. Enclose a free will offering.

\_\_\_\_\_ Church  
Box \_\_\_\_\_  
\_\_\_\_\_, Florida \_\_\_\_\_

Use of “churches,” “civic organizations,” “schools,” *etcetera*, are obvious alternatives to the now somewhat suspect foundation device as a vehicle for tax-privileged status.

### Urban Renewal Corporations

Under the federal Housing Act of 1965, non-profit organizations may build and operate low-rent housing projects, with urban renewal land almost *given* to them, and 100 percent of the capital loaned by the government at 3 percent mortgage rates (while the prime business interest rate, as of February, 1970, was 8½ percent). Then federal rent supplements are available, etc. Multimillion dollar projects already have been run, and are being run, by labor unions, churches, etc.

State Local Development Corporation statutes<sup>87</sup> help to provide state money, in addition. Most recently a twin combination of tax-exempt and business and governmental enterprise, called the *National Housing Partnership* and *National Corporation for Housing Partnerships* has been set in motion, to build 120,000 low cost housing units at a cost of \$2 billion. A prospectus was filed with, and approved by the S.E.C. proposing a \$50 million securities sale which, with tax-benefits, soon would produce \$2 billion, giving partners a profit of 17 to 20 percent a year.<sup>88</sup>

But in February 1970, sponsors of non-profit housing were alarmed by a statement by Eugene A. Gullledge, F.H.A. Commissioner in The Department of Housing and Urban Development, that, “. . . The non-profit sponsor does not belong in housing production except under a very limited set of circumstances. . . .”<sup>89a</sup>

<sup>87</sup> *E.g.*, Ohio Rev. Code, c. 1724, 1726, 1728; and at least until Sept. 1, 1970, N.Y. Memb. Corp. L., Art. XIX (1962).

<sup>88</sup> Rosenthal, *Private Housing Partnership Is Trying to Turn \$50 Million Into \$2 Billion*—*N.Y. Times*, p. 15 (Jan. 2, 1970); and okayed by S.E.C. on Jan. 15th, as reported in *Cleveland Plain Dealer*, p. 1 (Jan. 16, 1970).

<sup>89a</sup> *N.Y. Times*, p. 1 (Feb. 16, 1970).

## Land-Holding Organizations

In New York City alone, in 1969, about \$18 billion in tax-exempt real property was listed on the city rolls. This is over one-third of all the realty on the city assessment rolls, out of a total of about \$51 billion of real estate. The city, desperate, started an investigation. A New York *Times* article on November 25, 1969 (at p. 37) showed, in diagram form, that only 45.8 percent of the city's real property was *not* (yet) tax exempt.

Obviously, land holding by tax-exempt organizations is a huge, and growing, problem (or opportunity, depending on your point of view), throughout the nation.

In Ohio, the Ohio Public Expenditure Council reported in 1969<sup>89</sup> that 14.3 percent of the state's entire property value was tax exempt. Of this, about 60 percent was owned by governmental agencies, and 19.1 percent by churches. In Cleveland, about 25 percent of all real property was tax exempt. The National Council of Churches actually has asked its members to pay voluntary taxes.<sup>90</sup> Some churches already had done so, though tax exempt; e.g., First Unitarian Church in Shaker Heights, Ohio, paid several thousand dollars, voluntarily.<sup>91</sup>

## Bootstrapping

A discussion of non-profit organizations must mention the subject of *bootstrapping*. This is an arrangement for installment purchase of a business, without investment, by a non-profit organization (often specially organized for this purpose), using as payment the income of the business itself. It was sanctified as lawful, by the United States Supreme Court in 1965, in the the case of *Clay Brown v. Commissioner*,<sup>92</sup> despite the protests of the I.R.S. The Tax Reform Act of 1969 seems to have intended to begin the end of this device.<sup>92a</sup>

## Non-Profit Organizations for Housing the Elderly

Congress, in 1956, passed a law to provide public housing for elderly people. Then more laws encouraged non-profit building organizations to do this, with F.H.A.-insured loans at very low interest and covering 100 percent of costs.<sup>93</sup>

<sup>89</sup> *Cleveland Press* (Aug. 18, 1969).

<sup>90</sup> *Ibid.* And see, Robertson, *Should Churches Be Taxed?* (Westminster Press, Phila., Pa., 1968).

<sup>91</sup> I voted in favor of this, as a member.

<sup>92</sup> 380 U.S. 563.

<sup>92a</sup> 57 CCH Standard Fed. Tax Reports (3) Explanation, etc. (Dec. 30, 1969), Par. 1241.

<sup>93</sup> Federal Housing Admin., Office of Public Info.: "Mortgage Insurance on Housing for the Elderly," F.H.A. Consumer Bulletin #247 (revised May, 1965).

By 1965 a \$100 million retirement city of 5,000 units (for example) was in business in San Diego, with a church on the highest hill. The University of Arizona set up a separate non-profit corporation for F.H.A. funding of Tucson Green Valley (\$100 million). The retirement-building industry is growing 25 percent per year.<sup>94</sup> Practically all states have such housing under way. A project called "Lee-Seville" in Cleveland caused political fireworks in 1969 because it involved a large number of Negroes who had escaped from the city ghetto to the suburban green belt, and wanted no poor old people's housing project planted in their midst.<sup>95</sup>

Fringe income sources of housing for the elderly include 24 hour medical service and other services and facilities, while the age limit for "the elderly" is now 52 at Leisure World, 50 at Sun City, and 45 at New Horizons in Santa Barbara—all in California. Twenty percent of our population is expected to be so housed in 1970.<sup>96</sup> Cemetery annexes (also non-profit), undertaking services, etc., are growing, too. The possibilities, income, troubles, ethics, etc., are tremendous, and very involved.<sup>97</sup> Church-related housing is particularly popular.<sup>98</sup>

Senator John Williams of Delaware said, "These so-called non-profit homes for the elderly are being constructed under the guise that they are being sponsored by non-profit organizations." When, as sometimes happens, the cream of free money support is skimmed off to contractors, etc., bankruptcy is no real worry, as the F.H.A. then has to take over. "The Government furnishes all the money, takes all the risk, and the promoter gets a sure profit," the Senator added, in the *Congressional Record*<sup>99</sup> (titled "Irresponsible Use of F.H.A. Insurance").

Meanwhile, the numbers of "senior citizens" grow, and so do the opportunities for organizers and operators of non-profit organizations. But reaction to this sort of building is becoming apparent, even in H.U.D.<sup>99a</sup>

### Group Law Practice "Feeder Organizations"

*Group law practice* (e.g., counsel for all the members of a non-profit organization) now is O.K., under the famous *Button*,<sup>100</sup> *Brotherhood of*

<sup>94</sup> Friggen, "Where Life Begins at 65," Reader's Digest (Jan. 1966).

<sup>95</sup> See, Cleveland *Plain Dealer*, p. 1 et al. (various days in June, 1969).

<sup>96</sup> L. and L. Cooley, *The Retirement Trap* (Doubleday, Garden City, N.Y., 1965).

<sup>97</sup> Simon, *The New Years*, c. 5 (Knopp, N.Y.C., 1968).

<sup>98</sup> Scholler, Churches Enter the Housing Business, 80 *Christian Century* (#42) (Oct. 10, 1966).

<sup>99</sup> Of June 21, 1966.

<sup>99a</sup> See, *supra*, text at n. 89a.

<sup>100</sup> *N.A.A.C.P. v. Button*, 371 U.S. 415 (1963).



*Railroad Trainmen*,<sup>101</sup> and *United Mine Workers*<sup>102</sup> cases. Labor unions are only one type of "feeder organization." Fraternal orders, trade associations, and other types of non-profit organizations now can be (and are being) used.<sup>103</sup> This should be distinguished from "feeder organizations" aimed at supporting tax-exempt organizations. Under the Tax Reform Act of 1969 such operation will not be penalized by taxation as unrelated business income.<sup>103a</sup>

### New "Churches"

Proliferation of charitable—privileged churches, such as store front churches of exotic names and doctrines, long has been a problem. The numbers seem to grow endlessly—321,079 churches in this country in 1968.<sup>104</sup> Protected by Constitutional guarantees of freedom of religion, they are left very much alone by government authorities. Their tax-exempt assets are enormous.<sup>105</sup> Elmer Gantry types of promoters abound, and use them in great numbers. They have multiplied even more than usual in recent years. The civil rights commotion types are high-types of such modern churches, and many of the lesser ones are almost laughably remote from real religious purposes on the part of their *entrepreneurs*. The atheist-founded "churches" mentioned above (at notes 86a and 86b) are hilarious examples; very funny to everybody but "us taxpayers."

All (even personal) churches were tax-exempt in most states, not only directly, but even as to non-related profits, under the 1954 tax law, which exempted churches from taxes on "unrelated business income." A suit attacking this was begun in New York Federal District Court on January 24, 1969.<sup>106</sup> This case rested on *Flast v. Cohen*, a June, 1968 decision allowing any taxpayer to challenge government expenditures or exemptions.

In mid-1969, however, a New York Supreme Court in Nassau County (a suburb of New York City) ruled that religious organizations must pay taxes on "unrelated business income"—in that case, property leased for use by a day camp, commercially; this, referring to a State tax.<sup>107</sup>

<sup>101</sup> *Brotherhood of Railroad Trainmen v. Virginia Bar Assn.*, 377 U.S. 941 (1964).

<sup>102</sup> *United Mine Workers of Amer., Distr. 12 v. Illinois State Bar Assn.*, 389 U.S. 216 (1967).

<sup>103</sup> See, Symposium on Group Law Practice, 18 Clev.-Mar. L. Rev. (1) 1-52 (1969).

<sup>103a</sup> Act, Sec. 121(b) (7), amending I.R. Code Sec. 502 (effec. Jan. 1, 1970).

<sup>104</sup> See 1969 World Almanac figures, *supra*, immediately after n. 5 in the text.

<sup>105</sup> See, *supra*, 88-91, 98, *et passim*. And see, *supra*, at n. 90, Robertson, *op. cit.*

<sup>106</sup> *Protestants & Other Americans, etc. v. Distr. Director, and Stratford Retreat House* (incorporated in 1964). Reported in *N.Y. Times*.

<sup>107</sup> *Nassau County Board of Tax Assessors v. Temple Beth Sholom* (Nassau County, N.Y., Supr. Ct.) (reported in *N.Y. Times*, p. 1 on Aug. 20, 1969).

Private, commercial day camps understandably objected to competition-for-payment by a tax-exempt competition.

The Tax Reform Act of 1969 eliminated the exemption of church assets from the unrelated business income tax.<sup>107a</sup> Now only governmental and college organizations are exempt. A wave of "deals" with struggling or "nominal" colleges may be expected now.

### Racket Organizations

If outright larceny is practiced, of course, the crooks are in danger of prosecution, *if caught*. Thus, in Riverhead (Suffolk County, Long Island), New York, three men recently were indicted for using Girl and Boy Scouts to collect for a bogus charity for retarded children. A raffle of a car and a TV set were the basis of a sale of \$149,000 in raffle tickets and 3,000 coin canisters placed in stores, etc., to collect about \$8,000 more a month.<sup>108</sup> This is crude, and *gauche*, when one so easily can use lawful forms of organization for obtaining contributions from charitable people.

How many "non-profit organizations" actually are very profitable indeed to their managers or "owners," today, is known only to God—not to any governmental agency.<sup>109</sup>

### New York's New "Profitable Non-Profit" Statute

In late May, 1969, New York State adopted<sup>110</sup> a new "Not-For-Profit Corporation Law" to replace the old "Membership Corporations Law," effective September 1, 1970. It provides for four types of organizations:

Type A: Civic, political, fraternal, social, trade, and the like, corporations. (*e.g.*, primarily for members' purposes and benefits.)

Type B: Charitable, educational, cultural, cruelty-prevention. (*e.g.*, such as foundations.)

Type C: A not-for-profit-corporation "for any lawful business purpose." (*e.g.*, for what usually would be a business purpose, but "not to make money.")

Type D: A not-for-profit-corporation for "any business or non-business, or pecuniary or non-pecuniary purpose" specified by any other law than those in Types A, B, or C. (*e.g.*, such as Housing Corporations.)

<sup>107a</sup> 57 CCH Standard Fed. Tax Reports (3) Explanation, etc. (Dec. 30, 1969) Par. 1247.

<sup>108</sup> N.Y. Times, p. 53 (June 24, 1969).

<sup>109</sup> For some breath-taking figures, see, Hancock & Chafetz, *The Compleat Swindler*, 225, 226, 232 *et passim* (Macmillan Co., N.Y., 1968).

<sup>110</sup> Chapter 35 of the Consolidated Laws of N.Y.; Senate Bill 956-A, and 5338; A 1690. Signed by Governor Rockefeller on May 26, 1969.

Self-incorporation (one-man corporation not-for-profit) is provided for; and the incorporator need not be a natural person.<sup>111</sup> A judge's approval no longer is required for Types A or D.<sup>112</sup> "Subventions" (a new device) permit endowment which can be made returnable to the grantor.<sup>113</sup> These and other provisions bring to mind Delaware's well known statutes aimed at corralling business corporations (and income) for Delaware.<sup>114</sup> It may be that New York means to corral the very profitable non-profit organization business (and income) for New York.

The New York innovations are quite breath-taking. Their naive (we hope) view of the inevitably honest motives of human beings is hardly credible; certainly they cannot be so cynical as to *mean* to encourage use of charitable sheep's clothing as a cover for profitable business operations and personal enrichment! Yet, the new statute practically invites hypocritical lip service to altruism while personal profit is sought. Statements that the new Types C and D corporations are meant to encourage building of housing for the poor, development of black-owned business, etc., are quite unconvincing; more likely they will encourage many real estate operators (for example) to take their profits in tax-free-corporations-produced salaries and fringe benefits, rather than in the form of taxable corporate profits. The utter confusion of charitable and profit-making motives and operations, that they are sure to encourage, will be a nightmare for state and federal regulatory agents (such as *they* are) (e.g., there is only *one, young* Assistant Secretary of State to regulate the thousands of charitable trusts that trouble to register, in most states; and that is the usual extent of state supervision).<sup>115</sup> Yet, the recent S.E.C. approval of combinations of business, non-profit, and governmental organizations in tax-exempt housing enterprises makes the New York statutes look very "legitimate" (see above, text at note 88).

The provision for *subventions* might better have been titled *subversions*, in the new New York statute. The idea that a man may give a gift to charity, obtain the privileges and benefits thereof, *and then take back* the gift, with the blessing of the law, is so startling as to make comment futile. This is more than Alice-In-Wonderland; it is almost unbelievable that a legislature would enact such a statute.

<sup>111</sup> *Ibid.*, Sec. 401.

<sup>112</sup> *Id.*, Sec. 405.

<sup>113</sup> *Id.*, Secs. 501-521.

<sup>114</sup> See, Comment, "Law For Sale: A Study of the Delaware Corporation Law of 1967," in 117 U. of Penna. L. Rev. (6) 861 (April, 1969).

<sup>115</sup> Comment by Richard E. Friedman of Chicago, at the Michigan C.L.E. Seminar on Non-Profit Organizations, at Ann Arbor, Mich., on Aug. 23, 1969. Mr. Friedman, formerly First Asst. Atty-Genl. of Illinois, drafted the Illinois statute on regulatory law for such organizations. See, Gray, State Attorney-General-Guardian of Public Charities??? 14 Clev.-Mar. L. Rev. 236 (1965). But see, Note, Tax Exemption for Organizations Investing in Black Businesses, 78 Yale L. Rev. 1212 (1969), arguing that such exemptions should be granted.

The Internal Revenue Service may oppose the tax-exemption of organizations that try to take advantage of these provisions.<sup>116</sup> But Heaven only knows *what* may be tolerated, actually, considering the abuses and lack of supervision so long rampant in the non-profit organization business.

### The Danger Involved

The state of law and practice in the field of non-profit organizations, generally speaking, can be described only as *a mess*. Considering the importance of these organization forms and privileges in the United States, their vast contributions to the American (and other) progress and welfare, and the general lack of awareness of the *size* of the problem of their abuse and governance, the prospects for decent non-profit laws, operations, and (*above all*) effective supervision, are ominously bad.

The types of abuses are various, but one major type that cannot be fully treated here is the tendency of many non-profit executives to act as if they were *owners*.

As in business corporation management, so too in non-profit organization management (but without the honestly-self-serving candor of "business" managers, directors or executive committee members) seizure and holding of control (what I call "the proprietary mentality" of "activists") is common and often permanent. This is so widespread as to be taken for granted in many organizations. Lethargy of members and/or trustees, and disregard by supervisory authorities, are the common rules. Abuse of power is almost routine in many instances.<sup>116a</sup>

Present laws, practices, and lack of skillful and ample supervision, combined with normal human instincts towards self-enrichment—all combine to make a worrisome problem out of what *should be* a joyous and very proud part of our society: the non-profit organizations. Congressional tendencies in these days, as in the past, have been and continue to be to make pious noises very loudly, and then quietly to forget about the whole thing, with the excuse that we must not discourage charity. Thus, in December 1969, in the highly publicized "tax reform bills" in Congress, the Senate Finance Committee recommended a 40 year maximum life for foundations, but after a debate full of angry shouting the full Senate voted 69 to 18 to reject the proposal.<sup>117</sup> Senator Gore, of Tennessee, stated that the overwhelming majority of private foundations were created as tax havens for millionaires' funds, and to perpetuate their names. He said that one well-known foundation, which

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<sup>116</sup> Statement of Irwin J. Deutch of Detroit, at same Seminar cited *supra* (n. 1-9). Mr. Deutch was recently with the Office of Chief Counsel of the I.R.S.

<sup>116a</sup> See, Oleck, *Non-Profit Corps., etc.*, at Secs. 158, 187 (2d ed. 1965).

<sup>117</sup> U.P. Report, in *The Cleveland Press*, p. 1 (Dec. 5, 1969).

he called "one of the good foundations," had increased its assets from \$40 million to \$408 million—all exempt from taxation.<sup>118</sup>

*Self-Regulation Proposals:* Late in 1969 a plan for self-regulation by foundations was announced.<sup>119</sup> The plan was announced by Manning M. Pattillo, Jr., president of the *Foundation Center*, in New York City. A new "agency" was to be formed, he said, to "police" and "certify" this "multi-billion-dollar area." [Something akin to a *Good Housekeeping Seal of Approval* presumably may be given to participants.] It was hoped that the new "agency" could be operating sometime in 1970. The groups organizing it were the *Foundation Center*, the *Council on Foundations*, and the *National Council on Philanthropy*. The new "agency" is supposed to evaluate a foundation on request by it for such evaluation, publish lists of "approved" foundations, and investigate abuses when complaints or other information reveal "serious violations." Sanctions against those that refuse to rectify violations of standards to be set by this policing organization may include publication of adverse findings or referral to the Treasury Department. Preliminary standards already had been drafted by Mr. Pattillo's committee, including full disclosure, boards of trustees without donor's relatives or employees, clarity of statements of terms of grants, proper management of investments, expenditure of investment income within a year after receipt, prohibition of self-dealing by donors or their companies or relatives or trustees, and exclusion from involvement in election campaigns or advocacy of specific legislation contrary to the manner allowed by law. Alan Pifer, president of Carnegie Corporation, commented that "We have to rebuild confidence in the foundations."<sup>120</sup>

Unfortunately, in the announcement itself, the committee spoke again of "the nation's 22,000 foundations."<sup>121</sup> Apparently the quite different (much higher) counts of these organizations often announced by the I.R.S.,<sup>122</sup> the Attorney General of New York,<sup>123</sup> and others,<sup>124</sup> still were being treated as untruths. This does not seem an ideal way to begin to rebuild confidence in the foundations; when they persist in saying that *they*, and not the public authorities, are the only ones speaking the

<sup>118</sup> *Ibid.*

<sup>119</sup> "Agency to Police Foundations Is Being Formed by 3 Groups," *N.Y. Times*, p. 28 (Sept. 9, 1969); and for details see, A Program of Self-Regulation By Philanthropic Foundations, 10 *Foundation News* (6) 213 et seq. (Nov.-Dec. 1969).

<sup>120</sup> *Ibid.*

<sup>121</sup> *Id.*

<sup>122</sup> *Supra*, text just before n. 6; and at n. 84.

<sup>123</sup> *Supra*, at n. 85.

<sup>124</sup> *E.g.*, Patman Committee's estimate of over 45,000 in 1960. See, Oleck, *Non-Profit Corps., Orgns. & Assns.* 440 (2d ed., 1965), citing that committee's reports.

truth. The tremendous battle of the foundation lobbyists, to defeat the tax reform proposals of 1969-70, makes one wonder, too.<sup>125</sup>

Yet, this possible self-regulation supervision *may* work. It certainly is better than practically nothing—which is what the public authorities have provided to date.<sup>126</sup> For example, recently I was called to advise a certain non-profit association, formed in New York, but based in fact in Ohio, which had been picked up by the I.R.S. in one of its rare spot-checks. It had never filed a report with I.R.S., never had obtained tax exemption, never had even incorporated, and had been collecting contributions and acting as a tax-free charitable corporation for about half a century—*without ever being questioned by anybody*. Nor is this unusual. There are more than a few organizations that never have registered, nor filed any report, with anyone, not even perfunctory ones theoretically required in some states, while doing business for about a century now. In 1969 there was a year-long, front-page uproar in Cleveland about a sale of a charitable hospital, built with public funds, to a group to operate it as a profit business, and finally two groups (one of doctors and one a social agency) brought injunction proceedings; and only then did the Ohio Attorney-General file *also*, to question the transfer to private ownership.<sup>127</sup>

The I.R.S. presumably sees little point in checking up on non-profit organizations. Its job is to collect *revenue*, which these organizations do not pay. Basically, it should *not* be the agency charged with F.B.I., F.T.C., or other such kinds of duties of investigation. Yet, the I.R.S. is responsible for enforcing federal firearms regulations, through its alcohol, tobacco and firearms division. I.R.S. investigators in the past have brought prosecutions against persons whom Justice Department prosecutors had difficulty in convicting. Al Capone, for example, finally went behind prison bars on an income tax evasion conviction. But a hoodlum is not the same problem as a financial manipulator who operates with battalions of lawyers and accountants and under state statutes that encourage his manipulations.

The courts<sup>128</sup> worship the word “charity” in a foundation deed of trust, and do practically nothing.

State attorneys-general practically shun investigations of non-profit organizations. If they do investigate them, they make powerful enemies; if they punish them, they make vindictive enemies of the richest and most influential people and organizations in the state; and if they stop

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<sup>125</sup> Le Breton & Barnes (A.P. article) Foundation Lobbyists Beat Back Tax Curb, *Cleveland Plain Dealer*, p. 15a (Dec. 10, 1969).

<sup>126</sup> See, *supra* at n. 115.

<sup>127</sup> State Challenges Ingleside (Hospital) Sale, *Cleveland Plain Dealer*, p. 5D (Nov. 19, 1969).

<sup>128</sup> See the opinion in The *Scholler* case, *supra*, n. 78.

abuses they thereby also stop up the wells of charity, and are damned for doing that (not that they *do* it hardly at all).

What is needed is perfectly patent: for so big and complex and multitudinous and powerful a group of organizations, so thoroughly based on complex *state* laws, we need a special S.E.C.-type supervisory agency, both federal and in every state; not a branch of the I.R.S. Nothing less will do. We do not, and should not, want to stop the wells of charity and fraternity. We do not oppose foundations *per se*, for example, of course. But we do oppose abuse of the privileges of non-profit status.

The battered and bleeding middle-income taxpayers, already carrying the burden of most of the nation's woes and expenses on their aching backs, need and deserve protection, and they are *not* getting it in this area of law and government, as in many other areas. There is no profit (except some headlines for some politicians) in speaking up for the poor-dumb-middle class. These people do not pay big fees to counsel, nor appoint foundation trustees; nor do they blindly vote inevitably for rabble rousers. And their capacity for long-suffering meekness is almost incredible.

The foundations, using their vast resources to protect their own views, "mounted an elaborate counteroffensive against provisions of the Tax Reform Act of 1969, and it seems to be working. . . ." One observer at one hearing, said of the foundations' army of lawyers and P.R. men there: "It looks like \$60,000 a day worth of talent to me." The middle and smaller foundations mainly opposed even a limit of 20% on the stock of a corporation that may be held by a foundation. Some (*e.g.*, a certain foundation located in Philadelphia) even argued that it was a "matter of national policy" to permit families to retain control of their companies by setting up charitable trusts (tax-free foundations).<sup>129</sup>

This state of affairs—what amounts to *encouragement* of specially privileged status—has explosive possibilities. It has been said to be dangerously eroding our tax base, and shifting taxes to the not-wealthy.<sup>130</sup> What an unprincipled but charismatic demagogue could do with this genuine example of class privilege legislation and government (special privilege for an hereditary aristocracy of wealth based on use of bad law and smart lawyers), I leave to your imagination, and to your knowledge of history.

A hopeful development is the provision, in the new Tax Reform

<sup>129</sup> N.Y. *Times* (Oct. 13, 1969) "Foundations Gain in Fight Against Curbing Tax-Free Status"; and see, for the foundation view, "National Leaders Support Foundations," 10 *Foundation News* (6) 217 (Nov.-Dec. 1969). But see, Reiling, *Sham Foundations, Misused Foundations, and Income Taxation*, 47 *Taxes* 394 (1969).

<sup>130</sup> See the Patman Committee Reports (7, from 1961 to 1969) summed up early in, *Oleck, Non-Profit Corps., Orgns. & Assns.*, c. 31 (2d ed., 1965); and for a short rebuttal see, Robinson, *Is the Growing Income of Tax-Exempt Foundations a Threat to the Income Tax Base?*, 10 *Foundation News* (6) 235-240 (Nov.-Dec. 1969).

Act, of a requirement that foundations donate all of their annual *net* income to charity (an amount not less than six percent of their total assets), and limitation of their capital holdings; plus requirement of annual reports which also must be available to the general public. But, even here, one wonders how hard it will be to achieve a small *net* out of a large *gross* income.

### The Tax Reform Act of 1969

Others in this *Symposium* are treating the tax-exemption laws in detail, and I will not attempt to do so here.

Supposedly, the Tax Reform Act of 1969, effective January 1, 1970, signed so hesitantly by President Nixon in the last days of 1969,<sup>131</sup> is meant (among other things) to correct abuses by *foundations*. It says almost nothing about all the many *other* tax-exempt forms of organizations, such as clubs, fraternal orders, schools, churches, etc. It needs no genius to guess how easy it is to organize and "endow" a "church" or "school," instead of a "foundation," and still to control it.

The new tax bill will impose a small (4 percent) income tax on net investment (in U.S. sources) income of foundations; theoretically just enough to defray the government's costs of auditing and policing them. Foundations also will be obliged to pay out, annually, charitable grants up to six percent of their assets. Their extent of control of business corporations is supposed to be limited, while "propaganda" activities other than electioneering actually may be open to them more freely than before, with certain limitations; *e.g.*, distribution rules do not apply unless over 25 per cent of its income is from any one organization. Also, there are to be limitations on formerly unlimited charitable contributions.

All this sounds hopeful. But this cynical commentator (me), fears that the main effects will be inadequate supervision by inadequate governmental functionaries (at vast expense), shifting of tax-avoidance into more "church" or "school" or other tax-exempt forms of operation, more practice for lawyers and accountants, and smug dismissals of criticism (by rich "operators") with the half-true statement that "Now I pay taxes too" (and they will; just enough to be profitable).

The *Wall Street Journal* in early 1970 reported rumblings of discontent with the Tax Reform Act of 1969. In a small, front page item, it quoted the Communications Workers of America (in its "Labor Letter"

<sup>131</sup> N.Y. *Times*, p. 1 (Dec. 31, 1969); H.R. 13270, esp. Tit. I—Tax Exempt Organizations, Subtitle A—Private Foundations (Sec. 101), and Subtitle B—Other Tax Exempt Organizations (Sec. 121) Tax on unrelated business income; and Tit. II—Individual Deductions, Subtitle A—Charitable Contributions (Sec. 201). (P.L. 91-172). See, 57 CCH Standard Federal Tax Reports (3) (Dec. 27, 1969), and the 57 CCH Standard Fed. Tax Reports—Explanation of Tax Reform Act of 1969 (3) (Dec. 30, 1969), Pars. 1200 et seq.



column) as viewing the Act as "a first, feeble step toward meaningful tax reform," and as wanting more "loophole-closing."<sup>132</sup>

That is putting it mildly indeed. The next day, in its "Tax Report" column, the same *Journal* commented briefly on the "Tax Grab Bag: The sheer volume of the Reform Act obscures a potpourri of changes," and spoke of "about two dozen exemptions—all couched in general terms but narrowly tailored to benefit one or two firms or organizations—were tucked into corners . . . of the law. Some were meant to spare a few foundations from a requirement . . . (etc)."<sup>133</sup>

This is the kind of thing that makes one almost despair of democracy—were it not that other forms of government are worse.

Congressman Charles A. Vanik, of Cleveland, said "This bill will still permit certain American taxpayers of high income to escape taxation or pay much less than their fair share. . . . The pride with which some citizens escape taxation borders on tax treason."<sup>134</sup>

### Conclusion

Cassandra-like, I conclude by warning, again, that special-privilege-law, and/or special-privilege-nonenforcement of law, are sure paths to disaster for this nation. And our whole system of non-profit organization law is one big collection of special-privilege-law-and-nonenforcement. Many people now are saying that the whole idea of tax-exemption (e.g., of churches) is wrong.<sup>135</sup>

It would be bitterly ironic if our democracy should founder on this—its most cherished tradition, of brotherly cooperation for mutual benefit and charity, not for personal profit.

<sup>132</sup> *Wall Street Journal*, p. 1, col. 5 (Jan. 6, 1970).

<sup>133</sup> *Ibid.*, p. 1, col. 5 (Jan. 7, 1970).

<sup>134</sup> 115 Congressional Record (214) 1 (Dec. 22, 1969).

<sup>135</sup> See, Robertson, *Should Churches Be Taxed?* (Westminster Press, Phila., Pa., 1968); Blake, *The Church in the Next Decade* (Macmillan Co., N.Y.C. 1969); Larson and Lowell, *Praise the Lord for Tax Exemption* (Robert B. Luce, Inc., Washington-N. Y., 1969).