

LAW AND CONTEMPORARY PROBLEMS

VOLUME 39

AUTUMN, 1975

NUMBER 4

FOREWORD

Tax exempt status for charitable organizations has been a part of our federal income tax system from its inception and a deduction for contributions to such organizations has been a part of the income tax since 1917. As Kenneth Liles and Cynthia Blum document in their article, these provisions have been controversial parts of the tax system throughout their existence.¹ Large concentrations of wealth in private foundations have evoked concern, it appears, because they have been used, at the direction of a relatively few private citizens, to carry out quasi-public functions and have, therefore, presented a threat to the concentration of power over public policy decisions in elected public officials. Thus, what many persons view as a healthy contribution to to a "pluralistic society," not entirely reliant on governments for establishing society's priorities, others see as an undemocratic transfer of power from the body politic to a few individuals who happen to have great wealth.

There may be merit in both views. The decision to tax or not to tax any particular organization cannot be made without an allocation of society's resources between public and private control. Likewise, the decision to permit or deny a deduction for charitable contributions cannot be made without giving individuals either more or less discretion in how they use their own financial resources. Our tax system has been generous in permitting individuals to choose within the limits of supporting the public fisc or private philanthropy, and this is undeniably undemocratic. When members of Congress, with constituencies predominantly composed of individuals with little choice of this type, observe privately controlled resources being used in ways they believe to be less than optimum, or indeed, downright harmful to society, it is understandable that they might attack tax exemptions and deductions for charitable contributions as resulting in an unwarranted transfer of power from the body politic to private hands.

On the other hand, democracy is not merely a political system for concentrating all decisions in governmental institutions. Indeed, it may function

1. Liles & Blum, *Development of the Federal Tax Treatment of Charities*, 39 LAW & CONTEMP. PROB. no. 4, at 6 (1975).

best when it leaves as much decisional authority in private hands as possible without being neglectful of the welfare of its citizens. It is not much of a leap from this premise to the idea that diversity of private choice is so valuable to a democracy that it would be unwise not to encourage it by the very transfer of power that some find objectionable. Few would deny that private philanthropy has done much good in this country and many would agree with the following view of Douglas Dillon concerning the role of philanthropy, as well as his conclusion:²

The fact is that foundation innovations have set the pace for many activities which have long since ceased to be regarded as philanthropy at all. What is philanthropic today may be far from it tomorrow. When the Carnegie Foundation for Teaching set up its first retirement pension for teachers, this was philanthropy. But the pension systems now supplied by every college in the land are a cost of doing business, and in no way philanthropic. The millions raised by the Prosser Committee in the early thirties as *philanthropy* have been replaced by the welfare system as public policy. The provision of social security is now considered just as much a public obligation as is the furnishing of police and fire protection. . . . Surely we should be doing everything in our power to encourage foundations to continue these types of activities.

Lawrence M. Stone, recognizing the merits of both of these views, proposes a solution to balance the public and private interests. The freedom enjoyed by private foundations to make private decisions in committing their endowments to alternative public purposes he describes as being "at once [their] greatest virtue and [their] most vulnerable vice."³ Stone notes a number of areas where government regulation of private foundations is not only appropriate but should pose no threat to their independence. But he views maintenance of their freedom to make private decisions in allocating their resources as absolutely essential to their ability to function in the pioneering manner which Dillon describes.⁴ Although Stone proposes a variety of changes in the structure of governance of private foundations to reduce the conflict between public and private interests, the lynchpin of his system appears to be limiting the period of time during which creators of foundations can exert control or substantial influence over their operations.

The somewhat disparate points of view over the effect of the tax laws on financing education presented in the articles by Julian H. Levi and by John B. Kirkwood and David S. Mundel reflect in some degree this same conflict. Levi analyzes the different nature of private and public support for higher education in terms of the reliability of that support as well as the freedom each gives

2. Dillon, *The Role of Private Philanthropy in Modern American Society*, in TAX INSTITUTE OF AMERICA, *TAX IMPACTS ON PHILANTHROPY* 5, 9 (1972).

3. Stone, *The Charitable Foundation: Its Governance*, 39 LAW & CONTEMP. PROB. no. 4, at 57 (1975).

4. See Dillon, *supra* note 2.

to educational institutions in allocating their resources.⁵ He concludes that private support is so essential to excellence and diversity in higher education that tax incentives to encourage this support should be broadened. He finds this not only an efficient way to finance education but well worth whatever costs may be incurred by the public in giving up tax revenues.

On the other hand, Kirkwood and Mundel analyze private and public support for education in terms of the differences in the way the private sector and governments might allocate resources devoted to education.⁶ This quite directly poses the question of whether the majority of people in this country might be better served by a more democratic decisional process with respect to the allocation of funds devoted to education. The average voter, if familiar with the stakes, might well choose to exercise more control over this allocation by reducing tax incentives and electing representatives to allocate the resulting larger tax revenues.

These two articles present an interesting contrast in their views of the concept of tax expenditures, a concept that has been hotly debated in recent years.⁷ Professor Stanley S. Surrey deserves credit for promoting the idea that tax preferences, including exemptions from tax as well as the charitable contribution deduction, are a means by which the government spends money or subsidizes certain activities.⁸ Levi, however, joins the critics of this concept and points out that its implicit assumption is "reminiscent of the assumptions upon which feudal societies were organized."⁹ Kirkwood and Mundel, on the other hand, find Surrey's analysis irrefutable. Whether or not one agrees with the concept, it is clear that it has gained wide acceptance. As Levi notes, it has been accepted by Congress which now requires the annual budget of the United States to include a tax expenditure budget. It has also been accepted, at least implicitly, by a number of courts, including the Supreme Court, as a basis for deciding constitutional issues in a variety of tax cases.¹⁰ And, elsewhere in this issue, it draws the approval of Lawrence M. Stone and of Charles J. Goetz and Gordon Brady.

Robert S. Bromberg approaches this subject—the effect of tax laws on the financing of Health care—from a somewhat different vantage point.¹¹ He

5. Levi, *Financing Education and the Effect of the Tax Laws*, 39 LAW & CONTEMP. PROB. no. 4, at 75 (1975).

6. Kirkwood & Mundel, *The Role of Tax Policy in Federal Support for Higher Education*, 39 LAW & CONTEMP. PROB. no. 4, at 117 (1975).

7. This debate, which began with a debate over the so-called comprehensive tax base, has been summarized in W. KLEIN, *POLICY ANALYSIS OF THE FEDERAL INCOME TAX* 139 (1976).

8. See S. SURREY, *PATHWAYS TO TAX REFORM* (1973).

9. Levi, *supra* note 5, at 78.

10. The clearest acceptance of the concept by the Supreme Court appears in *Committee for Public Educ. & Religious Liberty v. Nyquist*, 413 U.S. 756 (1973).

11. Bromberg, *Financing Health Care and the Effect of the Tax Law*, 39 LAW & CONTEMP. PROB. no. 4, at 156 (1975).

proceeds from the premise that nonprofit hospitals need an expanding base of financial resources in order to serve the health needs of the country and that tax preferences are not only appropriate but necessary in meeting this goal. He then analyzes the term "charitable" as used in the exemption and education provisions of the Code to consider what types of nonprofit hospitals should be accorded these tax preferences. He argues that the traditional basis for preferential treatment, the use of available financial resources to provide free or below-cost care for indigent patients, is no longer appropriate. The implication of this is that health care for indigents should become an obligation of the government, funded by tax revenues, at the same time that resources allocated by favored tax treatment can now appropriately be directed to the exclusive benefit of those able to pay for their own health care. Bromberg's argument is in support of a rulings policy announced by the Internal Revenue Service in 1969. That change in administrative policy, made without a change in the statute, is a prime example of a resource allocation decision that could not muster enough support in Congress to be endorsed by specific legislation which was, in fact, proposed in 1969.¹²

The article by Liles and Blum discloses that there has long been concern over attempts by exempt organizations to influence legislation. They note that this concern prompted the Treasury to restrict this activity as a condition of exemption fifteen years before Congress added its legislative stamp of approval to such restrictions. The controversy has sharpened in recent years and is the subject of the article by Mortimer M. Caplin and Richard Timbie.¹³ They note that the national and state governments have involved themselves in so many areas of legitimate concern to charitable organizations that their range of activities may be unreasonably, and perhaps unconstitutionally, narrowed by the existing restrictions with respect to legislative activities.

Charles J. Goetz and Gordon Brady examine the effect of these restrictions on citizen interest groups and the consequent effect on formation of environmental policy.¹⁴ Their economic analysis leads them to the interesting conclusion that the restriction on legislative activities has had little effect on the ability of these groups to influence legislative policy. They then observe that

12. H.R. 13270, 91st Cong., 1st Sess., as passed by the House of Representatives, contained a provision in section 101 that would have conformed the Internal Revenue Code to the Treasury's ruling. It was stricken from the bill by the Senate Finance Committee, explaining that it wished to reexamine the matter in connection with pending legislation on Medicare and Medicaid. SENATE COMM. ON FINANCE, TAX REFORM ACT OF 1969, S. REP. NO. 552, 91st Cong., 1st Sess. 61 (1969). Subsequently, the staff of the Senate Finance Committee strongly recommended revocation of the ruling. STAFF OF THE SENATE COMM. ON FINANCE, 91ST CONG., 1ST SESS., MEDICARE AND MEDICAID—PROBLEMS, ISSUES, AND ALTERNATIVES 58 (Comm. Print 1970). To date, no action has been taken.

13. Caplin & Timbie, *Legislative Activities of Public Charities*, 39 LAW & CONTEMP. PROB. no. 4, at 183 (1975).

14. Goetz & Brady, *Environmental Policy Formation and the Tax Treatment of Citizen Interest Groups*, 39 LAW & CONTEMP. PROB. no. 4, at 211 (1975).

judicial and administrative actions create law which may have as great an impact on society as does legislation and argue that it makes little sense to restrict exempt organizations in attempting to influence the latter and not the former. Finally, they suggest that attempts to influence judicial or administrative law, in situations where the outcome is controversial, might be more appropriately restricted than attempts to influence a national or state consensus in their respective legislatures.

Many other criticisms of the operations of exempt organizations, and particularly private foundations, are revealed in the article by Liles and Blum as well as in the article by Stone. These include delay in the expenditure of funds accumulated for charitable purposes, diversions of such funds to private uses, business competition with fully taxed businesses, and control of private businesses. All were subjects of the complex regulatory scheme imposed on private foundations by the enactment of the Tax Reform Act of 1969.¹⁵ This Act has been widely criticized as hostile to private philanthropy and its impact has provoked a great deal of concern. Martin Worthy's article is an outline of that regulatory scheme and an expression of the concern it has evoked.¹⁶ Homer C. Wadsworth, who has long been involved in the management of large community foundations, also examines the impact of the 1969 legislation on private foundations.¹⁷ Although he obviously shares some of Worthy's concerns, he also finds a number of positive developments which have resulted from this legislation.

Private philanthropy has a long history in this country. It antedates the income tax and would undoubtedly continue, if not flourish, without the preferential tax treatment it now enjoys. The country can ill afford to weaken private philanthropy unnecessarily. But it seems healthy that the country is examining it critically and, now, realizing that there is a price to be paid for its benefits. It is hoped that this symposium will contribute to this examination to a more rational determination of the future of private philanthropy's relationship to the federal tax system.

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15. Act of December 30, 1969, Pub. L. No. 91-172, 83 Stat. 533.

16. Worthy, *The Tax Reform Act of 1969: Consequences for Private Foundations*, 39 LAW & CONTEMP. PROB. no. 4, at 232 (1975).

17. Wadsworth, *Private Foundations and the Tax Reform Act of 1969*, 39 LAW & CONTEMP. PROB. no. 4, at 255 (1975).