Lining Up the Pieces of the Jurisdictional Puzzle, or What's Subsidy Got to Do With It?

Laura B. Chisolm

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In his 1987 chapter on the Tax Treatment of Nonprofit Organizations in The Nonprofit Sector: A Research Handbook, John Simon used the term "the jurisdictional puzzle" to identify a series of questions concerning how, why, and to what extent the federal government, through the vehicle of tax exemption law, ought to involve itself in regulation of the fiduciary behavior of nonprofit managers, trustees, and donors.[1] Historically, and at its heart, oversight of charity is a function of state-based parens patriae power. Why does the federal government have any business regulating in this arena? What is the justification for federal regulation of charities, and how far does that justification reach? I want to elaborate upon the concept of the jurisdictional puzzle, because I think that, extended to encompass the range of existing and possible regulation of charitable organizations through the tax exemption laws, it can provide a useful framework for (1) assessing the validity and wisdom of what Congress has done by way of staking out its jurisdiction to regulate charity (and its corollary, identifying the scope of IRS jurisdiction to regulate charity); (2) understanding the contours of what Congress

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[1] John G. Simon, The Tax Treatment of Nonprofit Organizations: A Review of Federal and State Policies, in The Nonprofit Sector: A Research Handbook 68 (Walter W. Powell, ed. 1987).

is empowered to do by way of staking out its jurisdiction to regulate charity; and finally, (3) arriving at a sensible picture of what Congress should do by way of regulating the behavior of charitable organizations and those who run them.

What Piece of the Jurisdictional Puzzle Has Congress Claimed?

The first question arises when the IRS decides, for instance, to alter the Form 990 to ask for additional information, or takes a position, via regulations or implementation policy, on the content of some provision of the exemption law. This piece of the puzzle was implicated, for example, in the Supreme Court's understanding of the issue in the Bob Jones case, when it found the IRS's authority to revoke the university's exemption on the grounds of inconsistency with fundamental public policy between the lines of section 501(c)(3), where, according to the Court, Congress had impliedly placed it.[2] And it has been at the center of criticism, from time to time, of the Service's positions and actions. For example, Evelyn Brody suggests that the Service's insertion of itself into matters of governance by way of imposing conditions precedent to entering a closing agreement with the Bishop Estate was a usurpation of state regulatory territory for which there is no statutory basis in the exemption law.[3] Harvey Dale has questioned the Service's overreaching interpretation of the term "insider" for purposes of private

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[2]Bob Jones University v. United States, 461 U.S. 574 (1983).

[3]Evelyn Brody, A Taxing Time for the Bishop Estate: What is the I.R.S. Role In Charity Governance? 21 U. Haw. L. Rev. 537 (1999).

inurement analysis.[4] I have criticized the Service's position in the United Cancer Council case - cast by the Service in terms of private inurement, private benefit, and commerciality - as being, at bottom, a complaint about those in control of the organization coming up short in meeting their duty of care obligation. Unable to find evidence that Congress has ever exercised any intention to weave duty of care oversight over public charities into the exemption provisions, I concluded that the real issue in United Cancer Council was probably proper territory for state regulators rather than the IRS. I did keep open the possibility that a sufficiently careless decision on the part of organization controllers that resulted in the diversion of unduly large amounts of the organization's assets to an outside vendor or vendors might constitute non-incidental private benefit, which would bring the complaint within the jurisdiction of the IRS, after all.[5] And, while I can claim no credit for his outlook, Judge Posner saw it the same way in his opinion remanding the case to the Tax Court to decide whether "tax law has a role to play in assuming the prudent management of charities" and noting that "the board of a charity has a duty of care, just like the board of an ordinary business corporation, and a violation of that duty which involved a dissipation of the charity's assets might. . . support a finding that the charity was conferring a private benefit. . . ."[6]

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[4] Harvey P. Dale, Reflections on Inurement, Private Benefit, and Excess Benefit Transactions, paper presented to the Nonprofit Forum, October 17, 2001.

[5] Laura B. Chisolm, The I.R.S. and the U.C.C.: Traveling Down a Crooked Path, presented to the Nonprofit Forum, (sometime in the distant past).

[6] United Cancer Council v. Commissioner, 165 F.3d 1173 (7th Cir. 1999).

What *Can* Congress Do? How Big A Piece of the Jurisdictional Puzzle Is Congress Empowered to Take?

The second piece of the jurisdictional puzzle – what power does Congress have to regulate charitable organizations through the tax code – has two dimensions. The first requires identification of the sources of Congress's constitutional authority to regulate using the tax exemption and related provisions. The second goes to the question of whether constitutional constraints, independent of any possible limits inherent in Congress's authority to act in the first place, cabin Congressional jurisdiction in any meaningful way. To explore these questions, it is helpful to subdivide the pieces yet again. First, what kind of provision is at issue? Is it definitional, regulatory (in the sense that it imposes limits on the charity's behavior or, conversely, mandates particular behavior), or penalizing (defined here as imposing financial penalties cast as taxes)? Second, what is the subject matter of the provision - what kind of behavior does it regulate?

Attempting to characterize the nature of the provision is not without it challenges, and the project may be aided by first considering what we think exemption and deduction are really about. Approaching the question from the different perspectives of competing theories of the rationale for exemption and deductibility may lead to different characterization of a given statutory provision. Furthermore, subscribing to one theory over another leads to different answers to the basic question, "what is the basis of Congress's authority to regulate in this arena?"

Theories of Exemption and Deductibility

Clearly, the absence of tax liability, as compared to imposition of tax, is beneficial to those spared. Whether that absence is tantamount to affirmative subsidy, however, has been the subject of debate, as has been the question of what merits subsidy, if subsidy it is. Rob Atkinson[7] describes and compares the positions advanced by the major participants in the debate who, for the most part, represent two basic competing constructs.[8]

Tax Base Defining Rationales

The first is that tax exemption and deductibility of contributions necessarily follow from a proper definition of income. At the center of this position is the contention that an accurate and internally consistent definition of taxable income explains exemption and deductibility and that a support or subsidy rationale is neither needed nor accurate. In other words, if an item of revenue or property is not a proper part of the tax base in the first place, then the nontaxable treatment of that item should not be characterized or explained as a "subsidy" for the nonprofit sector. Boris Bittker, George Rahdert and William Andrews are chief proponents of this view. Bittker and Rahdert argue that the

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[7] Rob Atkinson, Theories of the Special Tax Treatment of Nonprofit Organiztions, in Frances R. Hill and Barbara L. Kirschten, Federal and State Taxation of Exempt Organizations ch. 15 (1994); Rob Atkinson, Atrruism in Nonprofit Organizations, 31 B.C.L.Rev. 501 (1990).

[8] Evelyn Brody has suggested that the terms in which both sides of the debate have been advanced have "sovereignty overtones." That is, our tendency, conscious or not, to view the charitable sector as quasi-sovereign leads us to stand back from imposing a tax burden while, at the same time imposing constraints designed to avoid allowing the sector and its institutions to become too powerful. Evelyn Brody, Of Sovereignty and Subsidy: Conceptualizing the Charity Tax Exemption, 23 J. Corp. L. 585 (1998).

exemption for charitable organizations arises from the fact that charities' income is not properly includable in the tax base for reasons internal to the tax system – the net income of charities does not fit comfortably within the tax system's usual definition of income, which rests on profit motivation – and that there is no way to determine the proper tax rate to apply, since the rate should reflect the individual rates of the organization's beneficiaries.[9] Deductibility of contributions to section 501(c)(3) organizations is explained by the assertion that a donation to a charitable organization neither increases the donor's net worth nor constitutes consumption,[10] or that it contributes to horizontal equity within the tax system.[11]

Subsidy Theories

The second is that tax exemption and deductibility represent a decision to provide indirect public subsidy to the organizations that benefit from them. Traditional subsidy theory holds that exemption and deductibility of contributions constitute indirect subsidies from government to promote the provision of certain kinds of benefits to the public. Public subsidy is warranted where normal market operations result in a less than socially optimal supply of a good or service that yields external benefits to the larger society. This typically occurs where the good or service is, in whole or

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[9] Boris I. Bittker and George K. Rahdert, The Exemption of Nonprofit Organizations from Federal Income Taxation, 85 Yale L. J. 299 (1976).

[10] William D. Andrews, Personal Deductions in an Ideal Income Tax, 86 Harv. L. Rev 309 (1972), Boris I. Bittker, Charitable Contributions: Tax Deductions or Matching Grants? 28 Tax Law Review 37 (1972), John K. McNulty, Public Policy and Private Charity: A Tax Policy Perspective, 3 Va. Tax Rev. 229 (1984).

[11] Mark P. Gergen, The Case for a Charitable Contributions Deduction, 74 Va. L.Rev. 1393 (1988).

part, what economists call a "public good" or "collective good," the benefits of which cannot be captured by any one user to the exclusion of others, or where a significant redistributive function is involved. Atkinson has described traditional subsidy theory as explaining that exemption and deductibility subsidize the provision of certain primary benefits – either goods and services that are deemed inherently good for the public, such as education, health care, social services, and arts, or ordinary goods and services that are provided to people recognized to be especially needy, such as food and shelter to the poor. In addition to these primary benefits, traditional subsidy theory has recognized some secondary benefits that arise not from the kinds of goods and services that are being supplied or from the characteristics of the people to whom they are being supplied, but rather, the fact that they are being supplied by organizations that are constrained neither by the usual operation of the marketplace nor by electoral accountability. Various commentators have identified innovation, decentralization, and pluralism as secondary benefits of this sort.[12]

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[12] See, e.g., John G. Simon, Charity and Dynasty Under the Federal Tax System, 5 The Probate Lawyer 1 (1978); Lawrence M. Stone, Federal Tax Support of Charities and Other Exempt Organizations: The Need for a National Policy, 1968 U.S. Cal. Tax Inst. 27, 45.

Critics of traditional subsidy theory find the rationale lacking a reliable limiting principle. Later proponents of the subsidy rationale have sought to identify a general substantive criterion that can explain existing law and, more importantly, provide a template for shaping exemption law in the future. In doing so, they have moved away from the traditional list of primary benefits and notions of general social welfare that characterize traditional subsidy theory. Some have looked to economics to supply a principle for sorting that which merits subsidy from that which does not. Hansmann proposed that because nonprofits are, by definition, unable to access equity capital, they

Traditional subsidy theory explains the charitable deduction as a reward to individuals who choose to support the socially valued undertakings that are, themselves, subsidized by the exemption.[13] Colombo justifies the deduction as an

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may be unable to expand rapidly to optimal size. This inefficiency may be addressed by allowing capital-constrained nonprofits to retain their net earnings through the subsidy of tax exemption. Henry H. Hansmann, The Rationale for Exempting Nonprofit Organizations from Corporate Income Taxation, 91 Yale L.J. 54 (1981). Hall and Columbo agree that the appropriate goal of the exemption subsidy is to correct market inefficiency that will not be addressed by the nondistribution constraint standing alone. Hall and Colombo find this market failure where goods and services are donatively financed, that is, they are consumed by individuals other than those who are paying for them. Because an individual's preference for redistribution may be met by redistribution financed by the donation of others, as well as (or instead of) by redistribution financed by his own contributions, donative financing is plagued by free riding. As a consequence, we may expect a chronic undersupply of donatively-financed goods and services, and the subsidy of tax exemption ought to be reserved for the correction of this market inefficiency. A corollary is that organizations that sell goods and services to their patrons ought not be subsidized through exemption. Mark A. Hall and John D. Colombo,The Donative Theory of the Charitable Tax Exemption, 52 Ohio St. L.J. 1379 (1991); see also James Bennett and Gabriel Rudney, A Commerciality Test to Resolve the Commercial Nonprofit Issue, 36 Tax Notes 1095, 1097-1098 (1987). Crimm suggests that exemption provides a government-financed "risk premium" as compensation to nonprofit firms for engaging in projects – the provision of public goods – that virtually guarantee lack of economic return. Nina J. Crimm, An Explanation of the Federal Income Tax Exemption for Charitable Organizations: A Theory of Risk Compensation, 50 Fla. L.Rev. 419. Atkinson proposes that the element of altruism is the secondary benefit that warrants the subsidy of tax exemption, and finds that element present "whenever an organization with the potential to return profit to its founders is set up on a nonprofit basis." "The exemption thus conceived would operate not as a susidy for any particular kind of good, nor for the provision of goods or services to any particular class of people, as traditional theory would have it. Instead, the exemption would operate to subsidize a secondary benefit: the altruistic provision of any good or service, to anyone." Rob Atkinson, Atrruism in Nonprofit Organizations, 31 B.C.L.Rev. 501, ___ (1990).

[13] Boris I. Bittker, Charitable Contributions: Tax Deductions or Matching Grants? 28 Tax L.Rev. 37 (1972). Another variant, proposed by Gergen, posits that deductibility is best understood as a subsidy that corrects for the free rider problem that inheres in provision of public goods and services. Individuals who choose to finance those endeavors are assisted by the subsidy, and individuals who choose to free ride are indirectly taxed. Mark P. Gergen, The Case for a Charitable Contributions Deduction, 74 Va. L.Rev. 1393 (1988).

additional mechanism for directing subsidy to the receiving charity, rather than as a reward to the contributing individual.[14]

Implications of the Two Theories for Answering the Question, "What is Congress Empowered To Do?

Sources of Authority for Jurisdiction

Definitional Provisions

If the subsidy theory, in any of its variations, is correct, then the answer to the question "what is the basis for Congress's authority to intervene in the affairs of charitable organizations?" is the spending power of Article I, section 8, a power with virtually no inherent limits.[15] If exemption and deductibility are functions of an accurately defined tax base, then the spending power is inapposite, and the basis of Congressional authority is the spending power's Article I, section 8 fraternal twin, the taxing power, which is equally unrestrained by inherent limitations.[16] In either case, the definitional provisions reflect necessary threshold Congressional choices. Under the subsidy view, the definitional provisions express what Congress has chosen to "spend" for; under the tax base defining approach, the definitional

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[14] John D. Colombo, The Marketing of Philanthropy and the Charitable Contributions Deduction, University of Illinois College of Law and Economics Working Paper No. 00-11 (2000).

[15] See United States v. Butler, 297 U.S. 1 (1936); Steward Machine Co. v. Davis, 301 U.S. 548 (1937); Helvering v. Davis, 301 U.S. 619 (1937).

[16] See United States v. Butler, 297 U.S. 1 (1936); Erwin Chemerinsky, Constitutional Law: Principles and Policies 199-202 (Aspen Law and Business 1997).

provisions describe entities that do not fit the technical criteria that underlie Congress's design of the tax framework.

Whichever rationale provides the starting place, it is often difficult to distinguish where definition ends and regulation in pursuit of other socially desirable goals begins. The process of identifying the ideal tax base is neither easy nor value-neutral.[17] But once the definitional line is set, additional features of the tax exemption law are pretty clearly regulatory overlays. Under subsidy theory, the line between definition and regulation becomes even more difficult. It is easy, and tempting, to conflate regulation and definition, characterizing any limitation or behavioral expectation imposed on exempt entities as part of the definition of what we are prepared to subsidize. That is, Congress's choice of what to "spend" for includes not only the ends to be pursued, but the means of pursuing those ends as well.

Regulatory and penalty provisions

Provisions like the section 4958 intermediate sanctions rules and attendant penalties that go beyond defining the object of government "spending" to superimpose regulation and penalties cannot logically be directly grounded in the spending power, even if one subscribes to the subsidy view of exemption and

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[17] See, e.g. Michael J. McIntyre, A Solution to the Problem of Defining a Tax Expenditure, 14 U.C. Davis L.Rev. 79, 84-85 (1980)(likening the process of distinguishing tax expenditure items from deductions necessary to reach an accurate measurement of income to the process of distinguishing a weed – "a plant that has no proper place in a flower garden" – from a non-weed. [P]art of what makes a weed a weed is an aesthetic judgment that it is out of place where it is. The same is true of a tax

deductibility. If one sees exemption and deductibility as resting on an accurate measure of the tax base, then once the definitional boundaries are understood, provisions that go beyond implementing fidelity to the definitions must be based on some other justification for federal intervention. What is the basis of authority for this regulatory overlay?

First, the regulatory provisions might be thought of as the means of patrolling the boundaries of the definitions. For example, the intermediate sanctions provisions might be characterized as a way to guard against private inurement, which is a central feature of either the subsidy or the tax base defining sense of the core definition of charity. Disclosure and reporting requirements might also be seen as necessary to effective implementation of definitional provisions. On the other hand, I would argue that the restrictions on various kinds of political advocacy are regulation, rather than either part of the definitional function or useful for keeping the edges of the definitions secure,[18] as are many of the requirements imposed on private foundations by the Chapter 42 provisions.

Even if the regulatory and penalty provisions cannot be justified as necessary or useful to monitoring the integrity of the central definitional construct of tax exemption law, Congress's authority to use the tax laws as a vehicle of regulation is undoubtedly sufficiently far-reaching to support virtually any kind of regulatory

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expenditure. Since their meanings depend in part on value judgments, their definitions necessarily have soft, fuzzy edges – not the crispness of an itemized list.").

[18] Cf. Mark A. Hall and John D. Colombo, The Donative Theory of the Charitable Tax Exemption, 52 Ohio St. L.J. 1379, 1438 (1991)(characterizing these provisions as part of the definition of "charity").

overlay it might want to insert into the Internal Revenue Code. Although historically, the distinction between a "true tax" and a "mere penalty with the characteristics of regulation and punishment"[19] may have had constitutional significance,[20] it seems safe to say that any possible argument based on that distinction is long gone – if it quacks like a tax, we'll call it a tax - and therefore within the broad taxing power of Congress - even if it looks like a regulation and penalty.[21] In any case, whether or not the taxing power provides a basis for federal regulation of charities, the commerce clause, even post-Lopez[22] would undoubtedly provide a footing for Congressional action in this sphere.[23] Thus, Congress's

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[19] Bailey v. Drexel Furniture Co., 259 U.S. 20, 39 (1922). See Laurence H. Tribe, American Constitutional Law, 2d ed. (Foundation Press, Inc. 1988) ("A tax is a regulatory tax – and hence invalid if not otherwise authorized – if the very application presupposes taxpayer violation of a series of specified conditions promulgated along with the tax.")

[20] See Hill v. Wallace, 259 U.S. 44 (1922); United States v. Constantine, 296 U.S. 287 (1935). But see Veazie Bank v. Fenno, 75 U.S. (8 Wall.) 27 1869; United States v. Doremus,, 249 U.S. 86 (1919) ("If the legislation enacted has some reasonable relation to the exercise of the taxing authority conferred by the Constitution, it cannot be invalidated because of the supposed [regulatory] motives which induced it.").

[21] See United States v. Kahriger, 345 U.S. 22 (1953) ("Unless there are provisons extraneous to any tax need, courts are without authority to limit the exercise of the taxing power." Id. at 31); Sonzinsky v. United States, 300 U.S. 506 (1937)("[If a provision] operates as a tax, it is within the national taxing power;" Id. at 514; "inquiry into the hidden motives which may move Congress to exercise a power constitutionally conferred upon it is beyond the competency of the courts." Id. at 513.).

[22] United States v. Lopez, 514 U.S. 549 (1995).

[23] Despite the big splash made by Lopez, see generally Symposium, The New Federalism After United States v. Lopez, 46 Case W. Res. L. Rev. 633 (1996); Symposium, Reflections on United States v. Lopez, 94 Mich. L. Rev. 533 (1995), it seems to have caused few ripples in the waters of commerce clause jurisprudence after all. See, e.g.,

authority to regulate charities, and to do it through the tax code, appears unbounded by any limits inherent in the constitutional sources of that authority, no matter how we understand the rationale for exemption and deductibility. Congress is constitutionally authorized to spend for almost anything, tax whatever it wants, regulate whatever it wants however it wants, and use tax as a mechanism for regulation wherever it can regulate by other means.

Constitutional Limitations External to the Source of Authority – Subject Matter of the Provision

Despite the nearly unbounded nature of each of the sources of its power to regulate, Congress is nonetheless constrained by constitutional limiters external to its constitutional sources of authority to act. The constraints are the same whether the form of Congressional action is spending, taxing, regulating, or regulating in the guise of taxing.[24] However, the impact of the constraints, or at least the way we need to think about how they work, may differ, depending on our underlying premise about the nature of exemption and deductibility.

Equal Protection

Most kinds of provisions that Congress has, or might, put into the tax exemption-related sections of the Internal Revenue Code, whether they represent spending, taxing,

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Glenn H. Reynolds and Brannon P. Denning, Lower Court Readings of Lopez, Or What If the Supreme Court Held a Constitutional Revolution and Nobody Came? 2000 Wis. L. Rev. 369. In any case, there seems little question that the universe of charitable organizations regulated by the tax exemption laws has sufficient interstate connections to implicate the commerce clause power even as circumscribed by Lopez.

[24] If Congress is constitutionally barred from regulating, it cannot avoid the bar by fashioning the regulation and penalty as tax measures. See Bailey v. Drexel Furniture Co., 259 U.S. 20 (1922); Sonzinsky v. United States, 300 U.S. 506 (1937).

or outright regulation, make distinctions that require only a rational basis for the choices. Thus, the decision to impose on private foundations, but not on public charities or other exempt or non-exempt entities, the self-dealing, jeopardizing investment, and pay-out requirement provisions of chapter 42 is unassailable on equal protection grounds, as would be a decision to extend the provisions to public charities, should Congress decide to do so. On the other hand, distinctions that are based on membership in a suspect class would be subject to strict scrutiny and would almost certainly be invalidated under an equal protection challenge. For example, Congress could not constitutionally choose to subject organizations with primarily African American membership, but not other organizations, to the section 4958 intermediate sanctions or to the chapter 42 rules and penalties.[25] If exemption and deductibility are subsidies, but not if they result from an accurate definition of the tax base, we are faced with difficult questions about whether Congress could, if it wanted to, overturn Bob Jones and allow exemption to racially discriminatory schools.[26] Likewise, the subsidy characterization, but not the tax base defining approach, raises the question of whether Congress is constitutionally bound to exclude from exemption organizations and programs that promote affirmative action or single-sex education.

Establishment Clause

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[25] See Regan v. Taxation With Representation, 461 U.S. 540, 544 (1983).

[26] In his dissent in Bob Jones, Rehnquist addressed the equal protection question the majority and concurring opinions avoided, noting that because section 501(c)(3) is facially neutral with respect to race, and any government "spending" occasioned by section 501(c)(3) would not be motivated by racial animus, it would not violate the equal protection clause. I suppose that a specific post-Bob Jones action by congress to overturn the result of that case could not meet the same criteria.

If the exemption and deductibility provisions constitute a subsidy, then the exemption of religious organizations raises an obvious problem – how can government spend in support of religion? The issue is less starkly outlined, but still present, if we believe the tax base defining theory. It is still present because, in order to decide that religious organizations satisfy the conditions necessary to fall outside the usual definitions of taxable income, we need to make some judgments about whether expenditures to support religion result in private consumption, and that inquiry would, it seems to me, require judgments about the nature of religion that are constitutionaly out of bounds.[27] Responding to challenges cast in subsidy terms, the Supreme Court appears to have drawn a distinction between measures that single out religion and those that merely encompass religious organizations as members of a broader, neutrally-determined class, namely "charity."[28] Presumably, the same formulation would work for questions raised under the tax base defining rubric.

First Amendment Free Speech Protection

Here, the mode of analysis to evaluate the impact of constitutional limitations diverges, depending on whether we start from a premise of tax exemption and deductibility as subsidy or from a premise of tax exemption and deductibility as a manifestation of accurately defining taxable income. If exemption and deductibility are features of an accurate technical definition of the tax base, and not subsidies, then anything outside of what is needed to arrive at an accurate measure of taxable income can

[27] See, e.g., Holy Spirit Ass'n v. Tax Commission of City of New York, 450 N.Y.S.2d 292 (1982).

[28] See Rochelle Korman, A Look Back at Walz v. Commissioner: Why Aren't Real Property Tax Exemptions for Religious Organizations Unconstitutional? Presented to the Nonprofit Forum, April 10, 1991.

be seen as a regulatory overlay superimposed on the entities that meet the technical definition. A regulatory overlay that directly imposes restrictions and penalties on core political speech is constitutionally suspect. If exemption and deductibility are subsidies, the framework of analysis is different, although it may take us to the same ultimate result. The constitutionality of a decision not to help pay for protected speech is measured against a rational basis standard. Only when the effect of a provision is to impose an independent penalty for engaging in constitutionally protected speech, rather than simply declining to subsidize the protected speech, is there reason for more searching inquiry using an unconstitutional conditions framework. Furthermore, the ability to segregate the protected, but not subsidized, speech from other functions of the subsidized entity may insulate the other functions from withdrawal of subsidy, and thereby avoid any potential penalty effect of constitutional significance. Taxation With Representation, upholding the constitutionality of the lobbying limits, explicitly rested on characterizing exemption and deductibility as subsidies, tantamount to government spending, and on the ability of the 501(c)(3) organization to lobby without limit, yet avoid losing the subsidy for its non-lobbying activities, by diverting the lobbying into a controlled, but formally and fiscally separate section 501(c)(4) affiliate.[29] In Branch Ministries v. Rossotti,[30] the D.C. Circuit simply extended the logic of Taxation With Representation to the election campaign intervention prohibition. Absent the "spending" characterization, it would be impossible, or at least far more difficult, to arrive at the same results in those cases. From a tax base defining perspective, the limitations on core political speech that are embodied in section

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[29] 461 U.S. 540 at ___.

501(c)(3) cannot be explained as a choice not to help pay for protected speech. Rather, unless they can be characterized as necessary and appropriate to arriving at a correct technical definition of what belongs in the tax base, they must be seen as direct limitation on protected speech, backed by a penalty measured by what an organization loses by loss of exemption. It is very difficult to characterize the lobbying limitations as features of a technically correct definition of taxable income. It may be easier to think of the campaign intervention bar in those terms, if campaign support may be seen to result in consumption of private goods by supported candidates. If the constraints are not simply definitional – that is, necessary to the description of what properly falls outside Congress's chosen definition of an accurately described tax base – then they can only been seen as direct restrictions on core political speech, violations of which result in penalties measured by the cost of non-exemption plus the loss of income that results from having gifts to the organization no longer deductible to the donor. Once cast as restriction and penalty,[31] rather than as choice not to subsidize, the provisions become constitutionally suspect.

The First Amendment is not absolute, so identifying the 501(c)(3) and related constraints on political speech as regulatory, backed by penalties, does not necessarily mean we would have to find them unconstitutional. But it does mean that the government would bear a heavy burden to show that they are justified by a strong

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[30] 211 F.3d 137 (2000).

[31] Granted, this penalty takes the form of a "tax," although it is an odd way to construct a tax. The more detailed scheme of regulation and penalties set out in section 4911 and the penalties provided by section 4955, although also called "taxes," fit a more conventional picture of "penalty" and were clearly conceived of as penalties when they were enacted.

governmental interest.[32] If the provisions are not part of the correct technical definition of an accurately defined tax base, so cannot be seen as necessary to monitor the integrity of the definitional boundaries, it is difficult to come up with a justification that could meet the demands of that standard.

Starting from the premise that exemption and deductibility are subsidies, as the Supreme Court did in Taxation With Representation, the analysis is different because, although Congress cannot prohibit and penalize speech, it may choose not to spend to help pay for protected speech without running afoul of the first amendment. There are limits to this statement. Congress may not make choices about spending to help pay for protected speech on the basis of suspect classifications or on the basis of viewpoint distinctions.[33] Thus, even starting from a premise that exemption is a subsidy, Congress could not constitutionally amend the tax exemption provisions to allow pro-life, but not pro-choice, section 501(c)(3) groups to engage in unlimited lobbying or campaign intervention.

Absent suspect class-based or viewpoint-based distinctions, Congress may freely choose whether or not to spend to support political speech. According to the Court in Taxation With Representation, that is all that the section 501(c)(3) political activity constraints do. If we concede that point, then subsidy theory takes us to a different result than the tax base defining theory with respect to the constitutionality of the constraints. If we challenge the court's characterization of the impact of the constraints, on the grounds

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[32] Turner Broadcasting v. Federal Communications Commission, 512 U.S. 622 (1994).

[33] 461 U.S. 540 at ___.

that the effect of the constraints is not simply to prevent the expenditure of "subsidized" dollars on lobbying or campaign intervention,[34] then we must analyze the constitutionality of the provisions under the rubric of unconstitutional conditions. I have argued elsewhere that the lobbying constraints would not survive that process because we cannot find a sufficiently important government interest that requires them.[35] I have also argued that the campaign intervention prohibition, as traditionally applied, unnecessarily (and therefore unconstitutionally) imposed the independent penalty of loss of subsidy for all of a section 501(c)(3) organization's activities on account of the organization's political speech, because of inability of section 501(c)(3) organizations to carry on election advocacy unimpeded through a separate affiliate.[36] The D.C. Circuit saw the problem the same way in Branch Ministries.[37]

Even if the Court in Taxation With Representation got it right about the impact of the section 501(c)(3) "no substantial part" standard, it did not have before it, so did not consider the constitutionality of the section 4911 or 4955 penalty tax provisions, which apply whether or not the political activity is funded with dollars for which a charitable deduction was taken. The evaluation of these provisions would, I think, be the same

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[34] In fact, the constraints penalize a section 501(c)(3) organization for using any of its resources, whether "subsidized" via the charitable deduction or not, for more than insubstantial lobbying or for any campaign intervention. Depending on the circumstances, the penalty may take the form of revocation of exemption or application of the section 4911 and/or 4912 penalty taxes.

[35] Laura B. Chisolm, Exempt Organization Advocacy: Matching the Rules to the Rationales, 63 Ind.L.Rev. 201 (1987).

[36] See Laura B. Chisolm, Politics and Charity: A Proposal for Peaceful Coexistence, 58 Geo. Wash. L.Rev. 308 (1990).

whether starting from a belief that exemption and deductibility are functions of an accurate measure of taxable income or from a premise that exemption and deductibility are subsidies. The reason for this lies in the nature of the provisions – they cannot be characterized as "spending" – they are pretty clearly designed to function as penalties attached to a scheme of regulation. The only way to find a difference in the way we think about these provisions starting from a subsidy mindset is to subsume the regulatory pieces of those sections into the definition of what we have chosen to subsidize. Thus, we have not chosen to subsidize charitable organizations and then subject their legislative activity to an overlay of regulation represented by the rules and penalties found in section 4911. Rather, we have chosen to subsidize charitable organizations that limit their lobbying as described in section 4911, and the penalty taxes are simply a mechanism for maintaining the integrity of the boundaries of that definition.

A similar analysis is apposite to the section 4945(d) penalty taxes imposed from the first dollar on the lobbying and campaign intervention activities of private foundations. Even if we concede, for the sake of argument, that Taxation With Representation got it right about the effect of the section 501(c)(3) lobbying limitation, the elaborate scheme of regulation and penalties imposed on private foundations' political activity by section 4945 clearly goes beyond a choice not to subsidize protected speech. The section 4945 provisions are pretty starkly constructed as a scheme of rules and penalties for breaking them that, together, add up to a prohibition. Furthermore, applying as it does from the first dollar of expenditure, it can hardly be said to be simply a tool for maintaining the integrity of the general 501(c)(3) limit of "no substantial part,"

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[37] 211 F.3d 137 (2000).

even if we accept, for the sake of argument, that that limitation is part of the definition of the ends and means on which we are willing to "spend." To justify the section 4945 rules as nothing more than a spending decision would require an additional layer of conflation of regulation with definition – we would have to say that section 4945 reflects Congress's decision to "spend" on private foundations that do not lobby at all. The section 4945 rules are part of the definition of the supported category of organizations, and the penalties of section 4945 are there simply to police the boundaries of the definition.

What *Should* Congress Do? - Policy Implications of Choosing a Theory

And that leads to the final piece of the expanded jurisdictional puzzle – how *should* Congress think of its role in regulating charities? Aside from the constitutional dimensions of the question, as a foundation for sound policy, careful attention should be given to working through the difficult puzzle of understanding the distinction between, on the one hand, defining and policing the boundaries between "charity" (worth "subsidy") and "not charity" and, on the other hand, using the justification of "subsidy" as leverage to effect non-tax policies. The temptation to subsume regulation of all sorts into definition is strong under a subsidy view of exemption and deductibility. Even if the subsidy view is correct, we ought to be very careful about letting "subsidy" become a slogan rather than an analytical tool.

Congress clearly has a great deal of room within which to operate to regulate charities through the tax code. It could, for example, impose chapter 42-like rules on public charities to put the IRS in the position of policing the duty of care dimension of the behavior of managers and trustees of charities. Or it could impose redistributional requirements as a necessary condition for exemption. Linda Sugin has suggested that tax law is "one of the few vessels that can still be legitimately filled with federal policy" and that it ought to be used to advance constitutional norms, as a matter of policy, beyond what the constitution requires, "even though it requires linking tax policy to ideas that are outside its traditional borders."[38]

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[38] Linda Sugin, Tax Expenditure Analysis and Constitutional Decisions, 50 Hastings L.J. 407, 473.

While the constitutional constraints on Congressional power to use the tax exemption laws for a variety of purposes may be essentially the same whether we think of exemption and deductibility as functions of an accurately defined tax base or as subsidies, the tone of the policy debate may be different in the two cases. Characterizing exemption and deductibility as subsidies, even if the characterization is correct, invites, although it does not command, a somewhat cavalier approach to policy formulation. Decisions about regulating charitable organizations through the tax code need not be automatically justified by saying (or thinking) "we are spending – we can choose what is worth spending on – in fact, we have an obligation to spend carefully and to restrict our spending to what the public would want to support." Rather, I would hope that there would be some clear articulation of the (granted, sometimes difficult to locate accurately) line between definition and regulation. Once we move away from spending power to taxing power or commerce clause power as the articulated or assumed basis of authority for assertion of federal jurisdiction to regulate exempt organizations, it seems to me that the discussion takes on a different flavor. "We can choose what to buy with our money" has a different ring than "we think this needs more federal regulation."