THE IRS AND THE UCC: TRAVELING DOWN A CROOKED PATH

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INTRODUCTION

Regulation of charitable solicitation and fundraising has traditionally been the province of the states, although to use the word "traditionally" is somewhat misleading, because regulation of fundraising practices is a relatively new phenomenon in this country.[1] The earliest laws specifically regulating fundraising were enacted in the 1950's. They were fueled by information that had been gathered as a result of reporting statutes that had been designed to enhance attorney general supervision of charitable organizations and the rapid expansion of new fundraising techniques. State interest in, and authority for, regulation of fundraising practices is rooted in part in the parens patriae authority, which is the source of the state's role as protector of assets dedicated to charitable use. But the states' attention to charitable fundraising practices did not begin as an outgrowth of the parens patriae role. Rather, it was driven by consumer protection and anti-fraud motivations.

States were inspired by reports of practices that seemed slick and unworthy of "charity." They were concerned about the big business aspects of charitable solicitation as it expanded and about the opportunities it provided for unscrupulous advantage by unscrupulous

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1. For excellent description and analysis of state regulation of charitable fundraising practices, see Leslie Espinoza, *Straining the Quality of Mercy: Abandoning the Quest for Informed Charitable Giving*, 64 S. CAL. L. REV. 605; ELLEN HARRIS, LYNN S. HOLLEY & CHRISTOPHER J. MCCAFFREY, FUNDRAISING INTO THE 1990'S, N.Y.U. School of Law (1989). The brief description of state regulation that follows is drawn from those sources.

profiteers. By the late 1950's, states began to enact regulations requiring disclosure of fundraising costs in particular, under the theory that disclosure of high fundraising costs would keep the public from being taken in by unscrupulous campaigns. Early disclosure was to the attorney general, however, and not to the general public. Noting that people were unlikely to seek out the information, states began in the 1960's and 1970's to move to public disclosure requirements and to actual limits on fundraising percentages.

In the 1980's, of course, the United States Supreme Court decided Schaumberg,[2] Munson,[3] and Riley.[4] Out of these three big bricks was built a formidable wall that seriously impeded the ability of state and local governments to go after what they considered to be troublesome fundraising practices. The newspaper stories continued, telling tales of look-alike charities,[5] loss of public confidence in charities,[6] low percentage of funds raised reaching the charitable purpose,[7] and excessive charges for management[8] and contracted services.[9] Watson & Hughey emerged as what appeared to be the quintessential unscrupulous

2. Schaumberg v. Citizens for a Better Environment, 444 U.S. 618 (1980).

3. Maryland Secretary of State v. Joseph H. Munson, Co., 467 U.S. 947 (1984).

4. Riley V. National Fed'n of the Blind of North Carolina, Inc., 108 S. Ct. 2667 (1988).

5. William Montague, *Proliferating "Look Alike" Cause Headaches for Many Charities*, CHRON. OF PHILANTHROPY, Jan. 9, 1990, at 25.

6. Clarine Nardi Riddle, *Charities Risk a Loss of Public Confidence if They Don't Help Fight Fund-Raising Fraud*, CHRON. OF PHILANTHROPY, Jan. 9, 1990, at 28.

7. William Montague, *Minn. Charities Said to Get 33 Pct. of Money Collected by Fund Raisers*, CHRON. OF PHILANTHROPY, June 27, 1989, at 21.

8. Pablo Eisenberg, *Corporate Values Could Poison Non-Profits*, CHRON. OF PHILANTHROPY, Mar. 10, 1992, at 41.

9. William Montague, *States Say Abuse Is Widespread in Charity Games*, CHRON. OF PHILANTHROPY, Mar. 6, 1990, at 1.

operator.

The states had some success combatting perceived fundraising abuses, but feelings of frustration continued, as inherent limitations of state ability to regulate and react allowed only what many thought was inadequate response to the perceived abuses.[10] Along the way, the Internal Revenue Service, as administrator of the federal charitable tax exemption, was beginning to get interested in the fundraising practices of charitable organizations.[11]

IRS interest came to flower in the Service's issuance of a Technical Advice Memorandum (TAM) in July, 1991, revoking the section 501(c)(3) exemption of United Cancer Council.[12] Most of the Memorandum details the arrangement between UCC and Watson & Hughey, which indeed looks like a very bad deal for UCC.[13]

The United Cancer Council arose from an internal dispute among local affiliates of the American Cancer Society over the Society's position with respect to combined fundraising campaigns and shift in programmatic emphasis from patient services to research support. The fight started in the 1940's and led to a split in 1959, when 88 of the American Cancer Society's local affiliates splintered off and formed a new federation -- the United Cancer

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10. *See* William Montague, *U.S. Ct. Rejects W. Va Plan for Enforcing Fund Raising Rules*, CHRON. OF PHILANTHROPY, June 27, 1990, at 27.

11. *See* BRUCE R. HOPKINS, THE LAW OF FUND-RAISING, 17-21 (6th ed. 1992).

12. IRS Technical Advice Memorandum, *reprinted in* 4 EXEMPT ORGANIZATION TAX REV. 726 (July 1991).

13. The facts are described here as presented by the IRS in the TAM and as stipulated by the parties in the subsequent litigation. Additional space and attention is given to the IRS's explanation for why it totally discounts UCC's representation that the mailings at issue were, in substantial part, educational. According to UCC, about half the content of its mailings was educational, and thus properly allocated to program expenditures. When the IRS looked at the mailings, though, it thought that something less than ten percent (by inch or by line) was educational, and that the little that was there was substantively trivial -- typically a list of the "Nine Cancer Warning Signals" in small print -- on a part of the mailing that had to be returned to enter the sweepstakes. *See* IRS Technical Advice Memorandum, *supra* note 12, at 733 & 736.

Council. Membership fluctuated over the years, but through the 1970's, UCC provided its affiliates with educational materials, fellowship and grant review services, and seminars and meetings. UCC was supported almost entirely by membership dues from the local affiliates. Like many other organizations in the 1980's, UCC began to experience the strain of rising costs and constant revenues. At that point, looking for a way to bring in funds, UCC made a deal with Watson & Hughey, a professional fundraising company.

The agreement specified that Watson & Hughey would front the costs of direct mail campaigns that were purportedly designed to bring in funds and, more importantly, to generate a mailing list of contributors who could be cultivated for future fundraising contact. Watson & Hughey would be paid five cents apiece for donor acquisition mailings and ten cents apiece for mailings to previous contributors. In addition, Watson & Hughey charged fees for design and printing of materials, receipt and accounting of donations, and miscellaneous other services in connection with the campaigns. Additional services were provided by for-profit companies related to Watson & Hughey. The terms of the contract gave Watson & Hughey full ownership of the mailing list names generated by the donor acquisition mailings.

Watson & Hughey's primary method of direct mail fundraising was a sweepstakes program that the IRS characterizes as being "like Publisher's Clearinghouse." The appeals tended to be fairly sleazy. The mailings suggested that the recipient had probably won $5,000; when the prize check arrived, it would be for ten cents. Many of the UCC local affiliates were put off by the new fundraising techniques, and a number of them withdrew from the UCC federation.

According to the IRS, out of $18,171,007 raised in the name of UCC in 1986 and 1987, only about 3.9% was spent on charitable program. Over 93% went to the for-profit Watson & Hughey,[14] which was also deriving a hefty income from renting and exchanging the mailing list names generated, sometimes with organizations that might be seen as UCC competitors. Publicity around Watson & Hughey and the UCC-Watson & Hughey deal got worse and worse, and UCC eventually decided to terminate its contract with Watson & Hughey. The organization signed on with another professional fundraiser that did not advance campaign costs. Using the lists generated by Watson & Hughey (which Watson & Hughey had now released to UCC for its own use only, but not rental or exchange), the direct mail effort was a fiasco. UCC filed for bankruptcy in June, 1990.[15]

THE IRS CASE AGAINST UCC - ROUND 1

After setting out the facts in the TAM, the IRS explained its rationale for revocation, justifying its decision on three grounds. First, United Cancer Council was not carrying on a charitable program commensurate in scope with its financial resources. In the TAM, the IRS stated that

> [t]he 'commensurate test' requires that organizations have a charitable program that is both real and, taking the organization's circumstances and financial resources into account, substantial. Therefore, an organization that raises funds for charitable purposes but consistently uses virtually all its income for

14. *But see, UCC Council Says Payment Figure Is Erroneous; Editor of Exempt Organization Tax Review Responds*, 92 TAX NOTES TODAY 184-54 (Sept. 10, 1992). (Counsel for UCC argues that percentage paid to Watson & Hughey Co. was much smaller, because most of the receipts went for expenses such as postage, printing, computer processing, etc.)

15. *Cancer Charity Files Bankruptcy Petition*, CHI. TRIB., July 10, 1990, at 3M.

> administrative and promotional expenses with little or no direct charitable accomplishments cannot reasonably argue that its charitable program is commensurate with its financial resources and capabilities.[16]

Second, UCC was operated for the private interest of Watson & Hughey rather than the public interest, as required by regulations under section 501(c)(3).[17] Third, UCC was operated for the substantial nonexempt purpose of operating "commercial type" sweepstakes games through Watson & Hughey.[18]

To the extent that the TAM engages in discussion of the legal authority for the IRS position and analysis of how that authority applies to UCC, the focus is largely on explaining and applying the "commensurate test."[19] And it was the Service's assertion of the "commensurate test" that drew the most reaction and criticism from the nonprofit community and those who pay attention to it.[20] It isn't hard to understand why. The test has some intuitive appeal -- do something worthy with the money you collect, or lose your charitable exemption -- but it also has some disturbing implications. The main criticism was that the test came out of nowhere -- it certainly was not one of those rules, or rules of thumb, that are routinely used to make exemption determinations, and it certainly had not been used before to

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16. 4 EXEMPT ORGANIZATION TAX REV. 726, 734 (1991).

17. *Id.*

18. *Id.*

19. BRUCE R. HOPKINS, THE LAW OF FUND-RAISING 147 (1992 Supp.).

20. Benson D. Tesdahl, *Improved Fund-Raising Through Commercial Coventures*, 7 EXEMPT ORGANIZATION TAX REV. 619 (1993).

evaluate an organization's fundraising efficiency.[21] Critics charged that the notion that "an organization must carry on a charitable program commensurate in scope with its financial resources" is unsupported by statute, regulations, or precedent in IRS enforcement of exemption laws.[22] Additionally, concerns were expressed about the open-endedness of the test. Just how efficient was the IRS going to decide an organization had to be in order to justify exemption (or continued exemption)? Which of the costs that lie between gross revenue in and net "charity acccomplished" would be among the "facts and circumstances" that the IRS would take into account to determine whether the failure to make real and substantial expenditures for charitable purposes is due to a reasonable cause, as opposed to being the very justification for revocation?[23] Clearly, in the UCC case the problem was the cost of fundraising, but the ruling did refer hypothetically to "administrative and promotional expenses" as the antithesis of "direct charitable accomplishments."[24]

In large measure, the critics of the commensurate test were right about the illegitimacy of the IRS statement and application of this supposed "rule." The 1964[25] and 1967[26]

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21. WILLIAM J. LEHRFELD, CHALLENGING DEVIANT FUND RAISING: COMMENTARY ON THE COMMENSURATE EXPENDITURE TEST FOR RETAINING 501(C)(3) STATUS (19xx).

22. Bruce Hopkins, *Not Happy with Fund-raising Developments*, 4 EXEMPT ORGANIZATIONS TAX REV. 132-3 (1991).

23. Thomas A. Troyer, *Quantity of Unrelated Business Consistent with Charitable Exemption -- Some Clarification*, 56 TAX NOTES 1075 (1992); BRUCE R. HOPKINS, THE LAW OF FUND-RAISING, 441 (1991).

24. IRS Technical Advice Memorandum, *reprinted in* 4 EXEMPT ORGANIZATIONS TAX REV. 726, 734 (1991).

25. Rev. Rul. 64-182, 1964-1 C.B. 186.

26. Rev. Rul. 67-5, 1967-1 C.B. 123.

revenue rulings that the IRS cited in support of the "commensurate test," when read for their substance rather than used as a mother lode of catchy phrases, really don't yield the rule that the Service claimed.

Looking at the documents cited by the IRS as the source of the commensurate test, and at the several documents purporting to apply the test over the years, one finds precious little support for the idea that the phrase and the concept it was meant to describe were intended to establish a threshold for 501(c)(3) qualification, as the IRS seems to assert in the United Cancer Council TAM. The test was originally devised in an attempt to reconcile apparently irreconcilable contradictions among provisions of the Code and Regulations (contradictions which resulted from faulty drafting). In fact, in a 1971 General Counsel Memorandum, the Service itself acknowledged this, and said that the commensurate in scope approach ought to be used "as the interim position of the Service pending a needed clarification of the regulations."[27] In the same GCM, the IRS explained the test rather elegantly:

> [T]he idea of an organization carrying on a charitable program 'reasonably commensurate with its resources'. . . was simply meant to convey the point that. . . if an organization is carrying on a real and substantial charitable program reasonably commensurate with its resources, that is just about the most conclusive evidence one could have as to charitable purpose of an organization in the administration of its properties.[28]

In other words, the commensurate test, in its origins, had to do with reassurance that an organization's apparently commercial activities, even if elaborate and extensive, are, in fact,

27. Gen. Couns. Mem. 34,682 (Nov. 17, 1971).

28. *Id.*

being pursued for charitable, not commercial, purposes. "Commensurate in scope" was designed to be a safe harbor, not a threshold test.

UCC filed a petition in the Tax Court to overturn the revocation.[29] The case came to trial in August, 1992, but progress was slow. A fair amount of procedural maneuvering and the testimony of the first few witnesses used up the scheduled courtroom time. The trial was completed in March and April, 1993, and the case now awaits briefing and decision.

THE IRS TRIAL POSITION - ROUND 2

Perhaps the Service was dissuaded by the criticisms of the TAM, or perhaps it just thought better of it independently; in any case, between issuing the TAM and showing up for the trial, the IRS dropped what had appeared to be the jewel in the crown of its revocation ruling -- the "commensurate in scope" argument. That was the line of argument that was most suggestive of conditioning exemption on fundraising percentage, although the IRS took pains to describe what it was doing in terms that might avoid that conclusion.[30] The Service continues to pursue the other two grounds for revocation, somewhat recast. In essence, the IRS has moved the UCC case out of the "regulation of fundraising" arena and into the "exploitation of exempt status for private benefit" arena.

In its case as presented in its Trial Memorandum,[31] the Service continues to rely on the remaining grounds for revocation, but presents them somewhat differently. The new

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29. United Cancer Council Trial Memorandum, *reprinted in* 92 TAX NOTES TODAY 170-74 (Aug. 20, 1992).

30. Technical Advice Memorandum, *reprinted in* 4 EXEMPT ORGANIZATION TAX REV. 726, 733-34 (1991). Of course, UCC took equal pains to assert that that's exactly what the commensurate test boils down to.

31. IRS Trial Memorandum, *reprinted in* 92 TAX NOTES TODAY 170-75 (Aug. 20, 1992).

approach eliminates the objections lodged about the commensurate test and leaves two well-known grounds for revocation that are undeniably based in statute and regulations: private, rather than public, benefit and substantial non-exempt purpose. Basically, the Service's argument is that UCC was not "operated exclusively" for exempt purposes, as required by IRC § 501(c)(3), because:

(1) more than an insubstantial part of its activities was not in furtherance of an exempt purpose;[32]

(2) UCC's earnings inured to the benefit of Watson & Hughey, a "private shareholder or individual" within the definition of Treas Reg. § 1.501(a)-1(c));[33] and

(3) UCC served the private interests of Watson & Hughey.[34]

The approach reflected in the IRS Trial Memorandum is to group these objections functionally and argue:

(1) UCC was operated for commercial purposes, namely, Watson & Hughey's. In the

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32. Treas. Reg. § 1.501(c)(3)-1(c)(1) specifies that "[a]n organization will not be . . . regarded [as operated exclusively for one or more exempt purposes] if more than an insubstantial part of its activities is not in furtherance of an exempt purpose."

33. Treas. Regs. §§ 1.501(c)(3)-1(c)(2) and 1.501(a)-1(c), taken together, provide that an organization is not operated exclusively for exempt purposes if its net earnings inure to the benefit of private shareholders or individuals, who are defined as persons having "a personal and private interest in the activities of the organization." The prohibition against private inurement is explicit in the statutory language of IRC § 501(c)(3) as well as appearing in the regulations as an element of the "operated exclusively" requirement.

34. Treas Reg. § 1.501(c)(3)-1(d)(ii) specifies: "An organization is not organized or operated exclusively for one or more exempt purposes unless it serves a public rather than a private interest. Thus, to meet the requirement of this subdivision, it is necessary for an organization to establish that it is not organized or operated for the benefit of private interests such as designated individuals, the creator or his family, shareholders of the organization, or persons controlled, directly or indirectly, by such private interests."

Memorandum, the Service asserts that "if UCC's assets and operations were directed towards commercial ends (even if they were not its own commercial ends) UCC's exempt status should be revoked because UCC was operated for commercial purposes."[35]

(2) UCC served the private interests of Watson & Hughey. According to the IRS, this factor has elements of both private (as opposed to public) benefit and private inurement. The apparent tie-in to the private inurement argument is the Service's contention that "[f]undraising and development of mailing lists were activities of UCC in which W & H had a 'personal and private interest.' Not only did W & H have financial interests in the activities, W & H had significant control over the conduct of these activities."[36]

It is heartening to see that the IRS has apparently shifted its strategy away from a focus on fundraising percentage to a focus on whether exempt status is being exploited for private gain. The new direction is rooted in the statute and regulations and is consistent with a general theme found throughout exemption law. Thus, the revised approach is more comfortable than the commensurate test -- at least at first glance.

Upon further examination, though, it appears that the IRS arguments, as laid out in the Trial Memorandum, distort the content of this familiar theme; the pathway the IRS constructs to get to its result is seriously flawed. There may be no legitimate path that leads to the result the IRS seeks in this case. If so, the result the IRS seeks should be avoided, despite the

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35. IRS Trial Memorandum, *reprinted in* 92 TAX NOTES TODAY 170-5 (Aug 20, 1992).

36. *Id.*

intuitive appeal of declaring the actions of UCC and Watson & Hughey out of bounds. On the other hand, the Service's position on UCC's disqualification for exemption may be ultimately correct. If this is so, however, there must exist a better path by which to reach it. It is worth the effort to find that better path, because the Service's route may take us not only to a UCC revocation, but on past it to places we do not mean to go, and because the shape of the path is likely, in the long run, to be more significant than the outcome in this particular case.

THE IRS TRIAL MEMORANDUM ARGUMENTS

In setting out its argument that UCC operated for commercial purposes, the IRS pulls analytical factors from a number of cases which have denied exemption on the same ground. The important variables identified are whether the organization competes with other businesses,[37] whether the challenged activities are extensive,[38] whether the organization supports another commercial enterprise,[39] and whether the organization has the substantial non-exempt purpose of operating an unrelated trade or business.[40] The Service then states that "most, if not all, of [the relevant] elements are present" in the UCC case.[41]

Granted, the IRS has ably listed the sort of variables that are relevant to a

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37. This factor is drawn from B.S.W. Group, Inc. v. Commissioner, 70 T.C. 352 (1978).

38. The Memorandum cites Pulpit Resource v. Commissioner, 70 T.C. 594 (1978).

39. This element is drawn from est of Hawaii v. Commissioner, 71 T.C. 1067 (1979).

40. This factor comes from Make A Joyful Noise, Inc. v. Commissioner, 56 T.C.M. 1003 (1989).

41. IRS Trial Memorandum, *supra* note .

determination whether an organization's activities are in pursuit of a commercial, rather than an exempt, purpose. The central problem with the case the Service puts forth here, however, is that three of the four cases concern questions about the motivation behind the commercial-looking activities of the exempt organization itself. This is, of course, the standard posture of commerciality inquiries. "It must be kept in mind that the law and the regulations refer to the taxpayer itself. The law and the regulations do not refer to a disassociated corporation."[42]

The one case cited that refers to the relationship between the would-be exempt organization and another is *est of Hawaii*.[43] The IRS represents *est of Hawaii* as "involving unrelated entities." In fact, the Service uses this characterization in an attempt to undermine UCC's contention that, because UCC and Watson & Hughey are unrelated, *Church By Mail*,[44] cited by the IRS in support of other arguments, is inapplicable to the UCC situation.

However, the IRS quotes language from the *Church By Mail* court's characterization of *est* that seems to undermine its own argument:

> We rejected the petitioner's claim that, since it was not formed by the same individuals who formed International (i.e., since it had 'no connection' with any for-profit corporation) and since its transactions with International were 'reasonable' and at 'fair market value,' it had no commercial purpose of its own. Instead, we agreed with respondent that the petitioner was part of a franchise system which was operated for private benefit and that the petitioner's affiliation with this system tainted it with substantial commercial purpose.[45]

Indeed, both the Tax Court and the 9th Circuit in *Church By Mail* note the real and tainting

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42. Science and Research Found., Inc. v. United States, 181 F. Supp. 526, 529 (1960).

43. est of Hawaii v. Commissioner, 71 T.C. 1967 (1979).

44. Church By Mail, Inc. v. Commissioner, T.C.M. 1984-349, *aff'd*, 765 F.2d 1387 (1985).

45. IRS Trial Memorandum, *quoting* 48 T.C.M. at 479.

connection between the for-profit and nonprofit organizations involved in that case, and cite *est* as most closely analogous to the situation before the court in *Church By Mail*, where "the extent of the integration between petitioner's activities, and those of its related entities, the control of those entities by [the controllers of Church By Mail]" left the court unconvinced that a principal purpose of the Church's operations was not to generate income for the private benefit of the controllers.[46]

The IRS also quotes language from *Church By Mail* to make the point that it makes no difference which of the exempt and non-exempt organizations is the "tool" and which is the user.[47] However, the sentences from *Church By Mail* that immediately follow the quoted language make it clear that the court there based its decision on the fact that the interrelated organizations there, exempt and non-exempt alike, "were all used as tools to enrich [their common controllers]."[48]

In the private inurement-private benefit portion of its argument, the IRS does not propose a clear reason why private inurement analysis is appropriate at all in this case, given the Service's early concession that the UCC-Watson & Hughey deal was at arm's length. The cases cited in this section of the memorandum uniformly derive from situations where individuals who controlled their organizations manipulated and siphoned wealth from the

46. 48 T.C.M. at .

47. "Petitioner here contends that *est of Hawaii* is distinguishable, because the petitioner therein was the 'tool' of a for-profit corporation, while here, according to petitioner, advertising was used as a tool for petitioner's activities. We refuse to decide this case upon the basis that it makes a difference through which end of the telescope one looks." *Id.* at , *quoted in* IRS Trial Memorandum.

48. *Id.* at .

organizational till into their own pockets.

The IRS Trial Memorandum does not deal with any non-private inurement private benefit cases, except by citing two "joint venture theory" cases (both of which were clear insider cases) in connection with its contention that the UCC-Watson & Hughey deal was a joint venture, and by referring to some of them in the discussion of commercial purpose. The Memorandum gives no consideration to the private benefit cases that are most analogous to the UCC situation, that is, cases in which an exempt organization compensates an unrelated, taxable person or entity for goods or services.[49] To analyze whether private inurement or private benefit is implicated in UCC requires a careful attempt to sort through existing private benefit and private inurement pronouncements[50] in order to identify and extract principles relevant to the case at hand.

<u>Sorting Out Private Inurement</u>

The proscription against private inurement is both a statutory command[51] and part of the regulatory explication of the operational test.[52] The IRS has characterized inurement as

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49. For a discussion of these cases and their implications for the UCC case, see *infra* notes and accompanying text.

50. There are limits to how thoroughly the cases and rulings can be sorted, however, because this is a particularly tangled area of tax exemption law. *See* New York State Bar Ass'n Tax Section, *Report on Exempt Organization Inurement Issues in the Context of G.C.M. 39862*, *reprinted in* 6 EXEMPT ORGANIZATION TAX REV. 1397, 1387 (1992).

51. IRC § 501(c)(3).

52. "An organization is not operated exclusively for one or more exempt purposes if its net earnings inure in whole or in part to the benefit of private shareholders or individuals." Treas. Reg. § 1.501(c)(3)-1(c)(2).

"likely to arise where the financial benefit represents a transfer of the organization's financial resources to an individual solely by virtue of the individual's relationship with the organization, and without regard to accomplishing exempt purposes.[53] This feature of section 501(c)(3) is a parallel to the nondistribution constraint that is at the center of state nonprofit corporation law; "[t]he obvious purpose of this provision is to deny exemption to an organization that pays a dividend, either directly or indirectly, to its members."[54] Violations take two basic forms. The first arises when those who control the organization bleed off its assets in any of a number of ways, such as paying themselves unreasonable salaries, as measured against market rates for the services rendered,[55] overpaying themselves for assets sold to the controlled organization[56] or underpaying the organization for assets purchased by the insiders,[57] receiving interest-free loans from the organization,[58] or paying personal

53. Gen. Couns. Mem. 38,459 (Jul. 31, 1980).

54. Passaic United Hebrew Burial Ass'n v. United States, 216 F. Supp. 500, 506 (D.N.J. 1963).

55. The "inference [is] that the purported salary payments were not intended merely to compensate him for services rendered, but were really authorized to assure him substantial distributions of appellant's annual net earnings in the form of salary. We think it doubtful whether comparable services would have cost as much had they been acquired in an arm's length transaction from an outside source." Mabee Petroleum Corp. v. United States, 203 F.2d 872, 875 (5th Cir. 1953). *See also*, Founding Church of Scientology v. United States, 412 F.2d 1197 (Cl. Ct. 1969).

56. E.g., Hancock Academy of Savannah, Inc. v. Commissioner, 69 T.C. 488 (1977).

57. E.g., Priv. Ltr. Rul. 91-300-02 (Mar. 19, 1991).

58. E.g., Orange County Agricultural Society, Inc. v. Commissioner, 893 F.2d 647 (2d Cir. 1990).

expenses out of the organization's funds.[59] This is not to say that a charitable organization may not compensate insiders for services performed,[60] pay personal expenses on their behalf that can legitimately be characterized as ordinary and necessary expenses of conducting the organization's regular activities,[61] or pay back money legitimately owed to an insider.[62] However, when an exempt (or would-be exempt) charitable organization makes such payments to controlling insiders, the burden is on the organization to establish that compensation is reasonable,[63] or that expenses assumed by the organization are legitimate

59. E.g., John Marshall Law School v. United States, 81-2 USTC 9514, ____(Ct. Cl. 1981). (organizer and family members paid for home improvements, television, washing machine, scholarships to family members, travel; "Theo Fenster was free to make personal use of such corporate funds for himself and his family when, if, and as he chose to"); General Couns. Mem. 37,065 (Mar. 25, 1977) (church officers used corporate funds to pay for yacht, penthouse, servants); Priv. Ltr. Rul. 92-090-08 (Nov. 27, 1991) (foundation set up to benefit disabled family member without jeopardizing Medicaid eligibility); Rueckwald Foundation, Inc. v. Commissioner 33 T.C.M. (CCH) 1383 (1974). (founder/controller used foundation funds to pay for elderly mother's care and son's education); Bubbling Well Church of Universal Love, Inc. v. Commissioner, 670 F.2d 104 (9th Cir. 1981).

60. *See, e.g.*, Mabee Petroleum Corp. v. United States, 203 F. 2d 872 (5th Cir. 1953); Gen. Couns. Mem. 35,945 (Aug. 13, 1974); A.A. Allen Revivals, Inc. v. Commissioner, 22 T.C.M. (CCH) 1435 (1963).

61. *See, e.g.*, St. Germain Foundation v. Commissioner, 26 T.C. 648 (1956). Universal Church of Scientific Truth v. United States, 74-1 U.S. Tax Cas. (CCH) P9360 (D. Ala. 1973).

62. Commissioner v. Kensico Cemetary, 96 F 2d 594 (2nd. Cir. 1938).

63. *See, e.g.*, Founding Church of Scientology v. United States, 412 F.2d 1197 (Ct. Cl. 1969) (taxpayer failed to establish that payments to founder and his family were reasonable in light of services rendered, given evidence that founder was drawing compensation from several other sources and that family members had provided no services at all); Bill Wildt's Motorsport Advancement Crusade v. Commissioner, 56 T.C.M. (CCH) 1401 (1989)(petitioner failed to carry the burden of showing that the amount he planned to draw from organization he established would be commensurate with value of services performed as trustee and as performer in purportedly educational motorcycle show "with showgirls dramatically costumed to match the project").

organizational expenditures.[64] Considering private inurement in Private Letter Ruling 9130002,[65] the Service noted the duty of loyalty dimension of this aspect of inurement doctrine: "Corporate directors are quasi-fiduciaries. . . they have an affirmative duty to put the interests of the organization above and before their own personal interests. Where there is even the slightest conflict as to which course of action to choose, Directors are legally obligated to put the organization's interests before their own."

Private inurement violations also arise where there is no breach of duty of loyalty principles but, rather, where an individual stands in the position of actual or de facto shareholder. For example, in *Birmingham Business College*,[66] the court found disqualifying private inurement where the founder/employees of the college issued and owned stock in the corporation and "the details demonstrated a relationship similar to that existing between a commercial profit corporation and its shareholders" in spite of the fact that there was no suggestion of "immoral or illegal conduct," but rather "a mutual sharing and sacrifice to keep

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64. *See, e.g.*, Cleveland Chiropractic College v. Commissioner, 312 F.2d 203, 206 (8th Cir. 1963) ("Bookkeeping was sloppy; Dr. Cleveland had a drawing account, into which went some of the expenditures for the College as well as some personal expenditures."); Kenner v. Commissioner, 33 T.C.M. (CCH) 1239 (1974) (intertwining of finances of hospital and founding doctor); Freedom Church of Revelation v. United States, 588 F. Supp. 693 (D.D.C. 1984) (no financial records produced to show that controlling individuals weren't using funds for personal benefit). Compare, however, Universal Church of Scientific Truth v. United States, 74-1 U.S. Tax Cas. (CCH) P9360, _______ (D. Ala. 1973), where fact that founder of church testified, "I was practically the church. . . . Going to get groceries was the church's business" did not prevent the Tax Court from upholding the exemption.

65 Priv. Ltr. Rul. 91-300-02 (Mar. 19, 1991).

66. Birmingham Business College, Inc. v. Commissioner, 276 F.2d 476 (5th Cir. 1960).

the institution alive."[67]

Sorting Out Private Benefit

Private inurement is both a separate category of sin and a subset of the requirement that an organization be operated for public rather than private benefit.[68] The private benefit universe, however, is decidedly more extensive than private inurement. Despite some suggestion that private benefit, though further-reaching than private inurement, is concerned only with benefit to an organization's "insiders,"[69] private benefit is generally accepted to encompass situations involving others than an organization's controllers. Most private benefit cases can be grouped into two categories; a few occupy a much less frequently encountered third.

Category 1 Private Benefit

The first category takes in cases that are close cousins to situations that raise private inurement concerns. They are not private inurement cases, because they involve no actual or de facto stock ownership or payment or hidden "dividends" to insiders through siphoning off

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67. *Id.* at 479. *See also* Kemper Military School v. Crutchley, 274 F. 125 (D. Mo. 1921) (school was owned by shareholders, who were paid a six percent annual dividend); Gen. Couns. Mem. 38,425 (June 30, 1980) (shareholder in nonprofit cemetary held prohibited equity interest); Lorain Ave. Clinic v. Commissioner, 31 T.C. 141 (1958) (structure of payments to participants was equivalent to distribution of organization's annual income).

68. American Campaign Academy v. Commissioner, 92 T.C. 1053 (1989). The requirement that an organization serve a public rather than a private interest, to the extent that it is broader than the private inurement proscription, is not explicit in the statute, but is found in Treas. Reg. § 1.501(c)(3)-1(d)(ii), which amplifies the § 501(c)(3) requirement that to be exempt, an organization must be organized and operated exclusively for exempt purposes.

69. Treas. Reg. § 1.501(c)(3)-1(d)(ii); Goldsboro Art League, Inc. v. Commissioner, 75 T.C. 337 (1980).

the organization's assets.[70] They are closely related, however, because they involve the organization's most central "insiders," that is, founders and controllers of the organization.[71] When "the interests of charity are sacrificed to the private interests of the founder or of those in control, exemption is precluded because the organization is being made to serve private interests."[72]

One classic variety of this general category of private benefit involves attempts to create an exempt shell from within which to carry on as usual. This subcategory is largely populated by "churches" that receive donations of all their founders' worldly goods, in turn providing for all their founders' worldly wants and needs,[73] and by private medical practices

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70. Some private benefit cases of this variety involve separate, but obviously related, allegations of private inurement as well. *See, e.g.*, Tony and Susan Alamo Found. v. Commissioner, 63 T.C.M. (CCH) 2422. Both private inurement and private benefit were found in this case of a religious organization which owned multifaceted business enterprises, including farms, a construction company, an auto repair shop, a record company, a grocery store, a freight company, "the glitter store of the world," and a restaurant in Nashville "where the stars dine," all staffed with volunteer labor of the organization's adherents and the proceeds of which kept the founder-controllers in "expensive elevator boots," $1,000 suits, and a $3 million house with a retractable solarium roof. "In the final analysis," found the Tax Court, "Tony and Susan were petitioner, hopelessly intertwined, with no separate identity, orchestrating a huge business organization (to be played by others) for their personal benefit."

71. In fact, some cases reflect the use of one label on the alleged basis for disqualification, but cast the analysis in the framework of the other. *See, e.g.*, Sonora Community Hospital v. United States, 46 T.C. 519 (1966) *aff'd* 397 F.2d 814 (9th Cir. 1968) (citing to private inurement language of statute, but framing discussion in private benefit terms); BHW Anesthesia Foundation, Inc. v. Commissioner, 72 T.C. 681 (1979) (alleging private interest, but basing analysis on private inurement cases).

72. Exempt Organizations Handbook (31 I.R.M. 7751) Part VII 382.2(1).

73. Athenagoras I Christian Union of the World, Inc. v. Commissioner, 55 T.C.M. (CCH) 781 (1988); National Ass'n of Am. Churches v. Commissioner, 82 T.C. 18 (1984); Ronald I. Peterson v. Commissioner, 53 T.C.M. (CCH) 235 (1987); Rev. Rul. 81-94, 1981-C.B. 136.

attempting to metamorphose into charitable clinics.[74] A second subcategory of this sort of private benefit cases contains the stories of controllers of exempt organizations who use the organizations as vehicles to enhance the fortunes of some other, non-exempt enterprise from which they stand to benefit. An organization established to design and market travel packages with a continuing medical education component, for example, was found to serve the private benefit of its founder, who owned and operated the travel agency with which the organization did all its business.[75] In a similar set-up the Tax Court found private benefit in an organization founded to assist individuals (who happened to be the clients of the organization's attorney-founder) to donate art (which happened to have been purchased from the founder's gallery).[76] Exemption has been denied on the basis of private benefit when the organization's purpose is seen to be supplying resources, even at market rates, to its controller's business ventures,[77] and when an organization is merely an instrument of

74. Lorain Ave. Clinic v. Commissioner, 31 T.C. 141 (1958); Rev. Rul. 69-266, 1969-1 C.B. 151; Rev. Rul. 56-185, 1956-1 C.B. 202; Rev. Rul. 55-229, 1955-1 C.B. 75.

75. International Postgraduate Medical Found. v. Commissioner, 56 T.C.M. 1140 (1989).

76. Ackerman Found. v. Commissioner, 52 T.C.M. (CCH) 152 (1986).

77. E.g., Columbia Park and Recreation Ass'n v. Commissioner, 88 T.C. 1, ____(1987) (organization "is an integral part of the Development and was created to serve Columbia, its residents and property owners" by supplying recreational facilities and community amenities); Paul G. Borman v. Commissioner, 26 T.C. 660, 665 (1956) ("principal activity of Foundation during the taxable years was the holding, maintaining, managing, and renting of the building, parking lots, and equipment needed by the physicians composing Clinic which controlled Foundation"); Rev. Rul. 72-147, 1972-1 C.B. 147 (organization formed to provide dwelling for low-income families is serving private benefit of its creator when all units are occupied by employees of founder's farm); Ohio Teamsters Educ. & Safety Fund v. Commissioner, 77 T.C. 189 (1981) *aff'd* 692 F.2d 432 (6th Cir. 1982) (educational organization formed as a result of collective bargaining is providing additional compensation for employment services rendered to organization's contributors). Compare Rev. Rul. 70-533, 1970-2 C.B. 112 (company-sponsored day care center exempt, because is open to the community and enrolls

investment manipulation or tax avoidance for its founder.[78] A recent instance of the latter variety of private benefit is described in Church of Spiritual Technology, where the Claims Court found that "[t]he complexity of Scientology's financial procedures, its dizzying array of reticules, and the potential for virtually constant transfers of funds, inevitably raise questions about the propriety of a tax exemption for CST, due to its links to that system."[79] The court concluded that "CST was brought about primarily to serve the non-exempt ends of other [non-exempt] Scientology organizations"[80] and "to serve L. Ron Hubbard as a personal estate planning device."[81] A final variant of this type of private benefit occurs where an organization's activities are designed to attract customers to its founders' business

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children on the basis of objective criteria).

78. E.g., Leon A. Beeghly Fund v. Commissioner, 35 T.C. 490 (1980) (trust was set up as vehicle for convoluted stock sale by founder where timing issues and other factors peculiar to this situation created the need for a straw man to hold shares of founder's company so that shareholders' sale of the stock would be taxable at capital gains rates); Stevens Bros Found. v. Commissioner, 39 T.C. 93 (1962) (organzation's operations consisted primarily of trading in securities with funds borrowed from organization's founders and lending proceeds to founders in their business ventures); Rev. Rul. 67-5, 1967-1 C.B. 123 (foundation controlled by creator's family operated to enable the creator and his family to engage in financial activities beneficial to them and detrimental to foundation). See also, Ohio Furnace Co. v. Commissioner, 25 T.C. 179, 193 (1955) (J. Pierce, dissenting)(charitable corporations were operated "for the purpose of permitting [three of organization's directors] to obtain the benefit of distributions of corporate profits before distribution and with the distributions being taxed only at capital gain rates"); Teich v. Commissioner, 48 T.C. 963 (1967), *aff'd* 407 F.2d 815 (7th Cir. 1969) (disagreeing with IRS contention that foundation's securities transactions resulted in the use of the foundation for the substantial purpose of benefiting founder's family and noting that at the end of the transactions, foundation was $1.2 million richer and family $1.2 million poorer).

79. Church of Spiritual Technology v. United States, 1992 Cl.Ct. 282, [* 72] (1992).

80. *Id.* at [*68].

81. *Id.* at [*65]. This opinion is a clear candidate for the Rhetoric Run Amok Award, offering (strained) references to Heisenberg, Sartre, and Goethe, all within a few pages.

establishment[82] or, in one recent case, to repel the wrong customers in the hope that the right customers would then be more likely to visit.[83]

Category 2 Private Benefit

The second general category of private benefit is derived from the common law concept that being charitable is based on providing a benefit to a charitable class, that is, either a distressed and disadvantaged group or a broad, indefinite public.[84] If an organization does not serve an inherently charitable class,[85] it must serve a broad public.[86]

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82. P.L.L. Scholarship Fund v. Commissioner, 82 T.C. 196, 196 (1984) ("more than an insubstantial purpose of the petitioner's activities was to attract persons, by the way of the bingo games, onto the premises of the Pastime Lounge, expecting that they would purchase food and beverages while participating in the games.")

83. Westward Ho v. Commissioner, 63 T.C.M. (CCH) 2617, ___ (1992). The creators of the would-be exempt organization described its purpose as "provid[ing] travel grants or loans to certain indigent and antisocial persons who may have a strong desire or need to leave the Burlington, Vermont area, but who lack the means to pay for transportation to their destination of choice." The planned activity of the organization was to provide tickets out of town for homeless persons who were disrupting the ambience of the founders' restaurants. In reply to the Service's allegations of disqualifying private benefit, the organizers argued that any private benefit they might derive from the works of the organization were "outweighed by the public opprobrium to which they have been subjected because of the creation of petitioners." *Id.* at ___. The Tax Court didn't buy it.

84. "[T]his proposition is simply an expression of a basic principle underlying the enforcement of charitable trusts and their exemption from federal tax under § 501(c)(3) -- that their property is devoted to purposes which are considered beneficial to the community in general, rather than particular individuals. See, e.g., IV Scott on Trusts § 348 (3rd ed. 1967)." Gen. Couns. Mem. 38,686 (Apr. 13, 1981).

85. Inherently charitable classes include, among others, the indigent, *see, e.g.*, Gen. Couns. Mem. 37,628 (July 31, 1978); low income elderly, *see, e.g.*, Gen. Couns. Mem. 35,775 (Apr. 11, 1974); and "disadvantaged artisans," *see, e.g.*, Aid to Artisans, Inc. v. Commissioner, 71 T.C. 202 (1978).

86. *See, e.g.*, Gen. Couns. Mem. 37,527 (May 5, 1978) (rural health care organization that serves all people regardless of ability to pay serves broad public); Gen. Couns. Mem. 35,210 (Jan. 26, 1973) (organization that welcomes back war veterans serves general public

The class served need not include every member of the community,[87] but in order to confer adequate community benefit, an organization's good deeds must be available to a cross-section of the population[88] rather than a delimited subset.[89] In any case, the class served must

benefit, because class of veterans is large enough); Gen. Couns. Mem. 39,327 (Jan. 18, 1985) (general membership tier in organization serves public benefit, because open to general community, but higher health club tier membership, limited because of cost, generates unrelated business income).

87. *See* Gen. Couns. Mem. 33,752 (Feb. 12, 1968).

88. *See, e.g.*, Sound Health Ass'n v. Commissioner, 71 T.C. 158, 185 (1978); Gen. Couns. Mem. 38,819 (Feb. 3, 1982).

89. *See, e.g.*, Baltimore Regional Joint Board Health and Welfare Fund v. Commissioner, 69 T.C. 554 (1978) (organization whose primary purpose was to benefit the members of a particular union by providing day care and other services, such as physical exams and immunization to its union membership); United States v. La Societe Francaise de Bien, 152 F.2d 243 (9th Cir. 1945) (operated for the benefit of members and limited to people less than 50 years old, of French birth, or descendents of French or French-speakers, and many of whom were well-to-do); Gen. Couns. Mem. 39,830 (Aug. 24, 1990) (doctors benefited by HMO are not a random section of community). The Tax Court and the IRS have disagreed about whether HMO membership constitutes a cross-section or a delimited subset of the community, with the court generally taking the position that the class is broad enough to justify exemption, *see* Sound Health Ass'n v. Commissioner, 71 T.C. 158 (1978); Geisinger Health Plan v. Commissioner, 62 T.C.M. (CCH) 1656 (1991), rev'd 985 F.2d 1210 (3rd Cir. 1993) (upon remand the Tax Court also found against Geisinger in clarifying its earlier ruling, 100 T.C. No. 26 [1993]); and the IRS arguing that a plan's membership alone is not a broad enough base of the community to qualify, *see* Sound Health Ass'n v. Commissioner, 71 T.C. 158, 167 (1978) ("The operation of the prepaid plan is supported by the premium paid by subscribers. . . . Further, the services are for subscribers only. Thus the broad benefit necessary to characterize the activity as charitable is absent."); Gen. Couns. Mem. 37,043 (Mar. 14, 1977); Geisinger Health Plan v. Commissioner, 985 F.2d 1210, 1219 (1993), *rev'g* 62 T.C.M. (CCH) 1656 (1991), *aff'd* 100 T.C. No. 26 (1993) (The Third Circuit recently backed the IRS position, holding that HMO subscribers are a definite group -- unless there is community benefit beyond subscribers, there is no basis for tax exemption. "The mere fact that a person need not pay to belong does not necessarily mean that GHP, which provides services only to those who do belong, serves a public purpose which primarily benefits the community.")

include an indefinite number of possible beneficiaries.[90]

Even if an organization's direct benefits do not fall on an inherently charitable class or the public at large, the organization may be charitable if the directly benefited class is simply a vehicle through which the distressed and disadvantaged or the broad public is served. For example, the fact that beginning lawyers subsidized by an organization to set up practices with substantial free service to indigent clients were not themselves poor did not defeat exemption, because they "were merely instruments" by which the organization's charitable work was accomplished.[91] On the other hand, a program to provide loans to minority health care professionals was found not to be charitable, because the minority physicians who were aided were not necessarily disadvantaged, nor were they expected to practice in underserved areas. Consequently, neither the program's direct nor secondary benefits fell upon a charitable class.[92] Sometimes direct benefit to non-charitable individuals can provide a

90. *See, e.g.*, Gen. Couns. Mem. 39,876 (July 29, 1992) (trust organized by graduating class for members who become destitute or disabled cannot be charitable, because group of beneficiaries is closed and narrow rather than indefinite; Gen. Couns. Mem. 38,818 (Feb. 2, 1992) (even if class of potential beneficiaries is small, so long as indefinite, can be exempt).

91. Gen. Couns. Mem. 34,992 (Aug. 17, 1972).

92. Gen. Couns. Mem. 39,633 (May 13, 1987). The Service has many times held that community development programs can be charitable, despite the direct benefit they may provide to individuals who do not belong to a charitable class. "Although some of the individuals receiving financial assistance in their business endeavors under the organization's programs may not themselves qualify for charitable assistance as such, that fact does not detract from the charitable character of the organization's program. The recipients of loans and working capital in such cases are merely the instruments by which the charitable purposes are sought to be accomplished." Rev. Rul. 74-587, 1974-2 C.B. 162. *See also* Gen. Couns. Mem. 39,883 (Oct. 16, 1992); Gen. Couns. Mem. 38,497 (Sept. 18, 1980); Gen. Couns. Mem. 36,298 (June 3, 1975). *Cf.* Gen. Couns. Mem. 38,826 (Mar. 10, 1982) (organization created to promote commercial growth in a particular area not charitable, because area to be served not poor or distressed).

secondary benefit to the public at large that is sufficient to justify exemption. The IRS recognized the exemption of an organization formed to engage in a federally-supported program to help minority businesses, noting that minority business owners are not a charitable class, but reluctantly conceding that the Congressional determination of important public interest reflected in the program probably sufficed for exemption.[93] The services an accounting firm would provide to non-exempt clients could be charitable, the Service ruled, if limited to analysis and research that could be published for the benefit of the general public.[94]

Certain spheres of activity are almost automatically recognized as providing important enough secondary public benefit to justify exemption, despite the fact that their primary benefit clearly goes to private individuals. Education is one of these, thus certifying the operation of bar association law libraries with limited (but not too limited) use[95] and fraternity/sorority study rooms for exemption.[96] This rationale, however, did not extend to a state-related trust designed to provide an investment vehicle for parents that would guarantee future college tuition for their children,[97] perhaps because the parent's pocketbook is a large

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93. Gen. Couns. Mem. 38,841 (Apr. 22, 1981).

94. Gen. Couns. Mem. 37,986 (June 19, 1979). It is undoubtedly significant that the firm's major planned activities were to provide services to nonprofit and indigent clients and to analyze the financial aspects of public issues.

95. Rev. Rul. 75-196, 1975-1 C.B. 155.

96. E.g., Gen. Couns. Mem. 39,612 (July 9, 1986); Gen. Couns. Mem. 35,897 (July 15, 1974); Priv. Ltr. Rul. 90-140-61 (Jan. 10, 1990).

97. Michigan v. United States, 802 F. Supp. 120, __ (W.D. Mich. 1992) ("the sole direct benefit inures only to individuals who purchase contracts").

step further removed than the student's head from the recognized public benefit that inheres in having an educated citizenry. Religion is another such sphere;[98] art, apparently, is not.[99]

Variable success among genealogy research groups in being recognized for exemption provides a quick map of the public benefit/private benefit landscape. A membership organization open to all that provides written materials on how to do genealogical research provides a public benefit,[100] as does an organization limited to a particular family, so long as its genealogical research is undertaken to perform the religious ordinances of the family's church.[101] But a one-family genealogy organization whose research will either enhance the earnings potential of a family asset[102] or just make members of even a very large extended family happy and proud[103] provides private, not public, benefit.

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98. *See, e.g.*, Rev. Rul. 74-575, 1974-2 C.B. 161 (organization furthers religious purposes by assisting the individual members to observe faithfully the dietary rules of the religion, and any benefit to those involved in the commercial preparation of foods is merely incidental); Gen. Couns. Mem. 38,827 (Mar. 23, 1982). *Cf. In re* Hutterische Bruder Gemeinde, 1 B.T.A. 1208, __ (1925) ("The members of the taxpayer have elected, as is their right under the laws of the Republic, to lead a communistic life. They constitute, in effect, a single family with two principal purposes -- the one to lead the sort of religious life that is pleasing and acceptable to them; the other to conduct business operations for the twofold purpose of supplying their own simple physical needs and enlarging their communal possessions. Like every other family [it may do this, but must pick up its share of the revenue burden].")

99. *See* Gen. Couns. Mem. 37,628 (July 31, 1978).

100. Rev. Rul. 80-301, 1980-2 C.B. 180.

101. Rev. Rul. 71-580, 1971-2 C.B. 235.

102. Manning Ass'n v. Commissioner, 93 T.C. 596 (1989) (historical family "manse" is operated as a restaurant).

103. Callaway Family Ass'n v. Commissioner, 71 T.C. 340, __ (1978) ("it is evident that they joined only because the purposes and activities of the organization were 'for' and 'about' Callaways"); Rev. Rul. 80-302, 1980-2 C.B. 182 (when genealogical research activities are limited to one particular family the activities do not advance education to benefit the public

This second category of private benefit may involve benefit to those who could be called insiders, but insider status in this context does not implicate the same kind of control of the organization that is the characteristic feature of category 1 private benefit.[104] Rather, it signals the narrowness of the class to be benefited, together with the absence of the characteristics of an inherently charitable class. These are situations where the organization is operated for the mutual benefit of its members. A class of beneficiaries limited to an organization's members generally is too definite to be charitable.[105] Thus, the Service is inclined to deny exemption to professional referral services,[106] although the Tax Court appears to recognize a broad public benefit in such services despite the benefit to members.[107] Membership retirement benefit plans are generally thought to provide private, not public, benefit.[108] Prepaid benefit plans of various sorts routinely fail to claim

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interest).

104. *See supra* notes and accompanying text.

105. For a brief discussion of the ongoing dispute about the application of this principle in the context of HMO's, see *supra* note .

106. Rev. Rul 80-287, 1980-2 C.B. 185 (lawyer referral service); Rev. Rul. 61-170, 1961-2 C.B. 112 (practical nurses' registry); Gen. Couns. Mem. 37,853 (Feb. 9, 1979) (lawyer referral service).

107. Kentucky Bar Found. v. Commissioner, 78 T.C. 921 (1982); Fraternal Medical Specialist Services, Inc. v. Commissioner, 49 T.C.M. (CCH) 289 (1984).

108. *See* Retired Teachers Legal Defense Fund, Inc. v. Commissioner, 78 C.T. 280 (1982); Rev. Rul. 81-58, 1981-1 C.B. 331 (Police Officers' Association retirement fund). *Cf.* Rev. Rul. 87-126, 1987-2 C.B. 150, where a firefighters' retirement fund which was not a membership organization as such, but a quasi-public body providing a government-mandated benefit, was exempt.

exemption,[109] as do organizations providing benefits that are seen to be internal to their membership rather than external.[110]

Again, activities that provide a public benefit in one context may signal private benefit in another. Cleaning up a smelly waterway was a private benefit activity when undertaken by an organization whose members were mostly waterfront property owners and there was virtually no public use of the waterway.[111] But an organization financed by contributions from lakefront property owners, members of the community, and municipalities bordering the lake, and formed to preserve a lake that was used extensively by the public was found to provide benefit principally to the general public.[112]

Category 3 Private Benefit

The third category of private benefit takes in situations where financial benefit to outsiders[113] is generated by an organization's operations. This may be a situation where the

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109. *See, e.g.*, El Paso DelAquila Elderly v. Commissioner, 64 T.C.M. (CCH) 376 (1992); Gen. Couns. Mem. 35,566 (Nov. 16, 1973) and Gen. Couns. Mem. 37,504 (Apr. 14, 1978) (prepaid legal services plans).

110. *See, e.g.*, Rev. Rul. 69-175, 1969-1 C.B. 149 (cooperative school bus service); Rev. Rul. 71-395, 1971-2 C.B. 228 (cooperative art gallery); Rev. Rul. 65-1, 1965-1 C.B. 226 ("[industry] association's research projects may result in new products and processes that benefit the public, but such benefit is secondary to that derived by the association's members").

111. Benedict Ginsberg v. Commissioner, 46 T.C. 47 (1966).

112. Rev. Rul. 70-186, 1970-1 C.B. 129.

113. Although the Tax Court has a propensity for saying that the private benefit issue concerns only benefits to insiders, *see, e.g.*, Sound Health Ass'n v. Commissioner, 71 T.C. 158 (1978) and Goldsboro Art League, Inc. v. Commissioner, 75 T.C. 337 (1980), the IRS certainly doesn't agree, *see, e.g.*, Gen. Couns. Mem. 38,686 (Apr. 13, 1981), and the IRS view is more widely accepted.

organization itself is paying outsiders for goods or services. Private benefit questions of this variety have been raised, for example, where a scientific organization paid a for-profit publisher to produce, distribute and sell the organization's materials,[114] where a theater organization hired a booking agent,[115] where an arts organization sold artists' works on consignment,[116] and where an organization paid a percentage to consultants who managed to attract gifts from wealthy donors to the organization's member organizations.[117] Alternatively, the organization's activities may generate income that is directed to or shared with outsiders.[118] Cases that involve joint ventures with previously non-connected individuals or non-exempt organizations[119] fit this classification, as does, for example, the case of an organization that sought sponsors and solicited program guide subscriptions on

114. Science and Research Found., Inc. v. United States, 181 F. Supp. 526 (S.D. Ill. 1960).

115. Broadway Theatre League of Lynchburg, Va., Inc. v. United States, 293 F. Supp. 346 (W.D. Va. 1968).

116. Goldsboro Art League, Inc. v. Commissioner, 75 T.C. 337 (1980).

117. National Found., Inc. v. United States, 13 Cl. Ct. 486 (1987).

118. A third variety that likely fits this general classification includes situations where an organization provides counselling designed to assist individuals in capturing maximimum tax benefits from charitable giving. *See, e.g.*, Ecclesiastical Order of the Ism of Am v. Commissioner, 80 T.C. 833 (1983); Ackerman Found. v. Commissioner, 52 T.C.M. (CCH) 152 (1986); Christian Stewardship Assistance, Inc. v. Commissioner, 70 T.C. 1037 (1978); Rev. Rul. 76-442, 1976-___ C.B. 519. These cases differ from the others in this general category, however, because the financial benefit that accrues to the non-exempt individuals is not one that could have been acquired or retained by the exempt organization. This variant, in fact, might be seen fitting the Category 2 "benefited group is neither inherently charitable nor broad enough," but is grouped with Category 3 because of the distinctly financial nature of the benefit.

119. These cases are discussed at *infra* notes   and accompanying text.

behalf of for-profit classical radio station in order to forestall loss of classical music format in the community.[120]

The IRS Trial Memorandum does not explicitly consider non-inurement private benefit, but does brush against it by citing *Stevens Brothers Foundation*[121] and *Lorain Avenue Clinic*[122] in connection with its argument that the United Cancer Council-Watson & Hughey deal was a joint venture, and to *est of Hawaii*[123] in the discussion of commercial purpose. The criticisms expressed above[124] with regard to the Service's reliance on *est of Hawaii* are equally apt here. Although it is true that the Tax Court in *est* looked past formal control of the would-be exempt organization, it is clear that the fact that the for-profit entities that stood to benefit from the work of the exempt organization were its creators[125] and franchisers, with almost complete control over the composition, conduct, and management of the exempt organiztion, was a decisive factor.

The IRS does not cite the Category 3 private benefit cases that are arguably most analogous to the UCC situation. For example, in *Science and Research Foundation*, the court explained that paying an outsider for goods and services to carry out the organization's

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120. Rev. Rul. 76-206, 1976-1 C.B. 154.

121. Stevens Bros Found. v. Commissioner, 39 T.C. 93 (1962).

122. Lorain Ave. Clinic v. Commissioner, 31 T.C. 141 (1958).

123. est of Hawaii, A Hawaiian Corp. v. Commissioner, 71 T.C. 1067 (1979).

124. *See supra* notes   and accompanying text.

125. It is significant that Treas. Reg. 1.501(c)(3)(-1(d)(ii), which articulates the public interest component of the operational test, includes "creator" in the list of private interests that might be problematic.

mission is not and cannot be considered to make the organization's purpose commercial or for private benefit,[126] even where the bulk of the organization's resources were funneled through the unrelated for-profit company. In *Broadway Theatre League of Lynchburg*, which involved an exempt theater group's contract with a for-profit booking agent, the court noted that "[t]he prohibition in 501(c)(3) against any benefit inuring to private shareholders or individuals clearly and without question refers to the organization contemplated in the first sentence of the statute and not to any dissociated organization such as the legal services, secretarial services, or from. . . an organization. . . who has a bona fide contractual relationship with an exempt organization."[127] The IRS itself has found that the fact that an exempt organization spends all of its resources for dealings with one for-profit supplier of goods and services does not necessarily disqualify the organization for exemption. In Private Letter Ruling 9208028,[128] the Service did not even identify private benefit concerns when a day care center proposed to keep its exempt identity but turn over the conduct of its program and virtually all the revenues associated with it to a for-profit day care provider.

The Service's argument that the United Cancer Council-Watson & Hughey connection was a joint venture is no more satisfying, because no attempt is made to explain how and why the arrangement constitutes a joint venture or to analyze carefully which features of the arrangement, even if it is a joint venture, make it a problematic joint venture. The IRS cites

126. Science and Research Found. Inc. v. United States, 181 F. Supp. 526, 529 (S.D. Ill. 1960).

127. Broadway Theatre League of Lynchburg, Va., Inc. v. United States, 293 F. Supp. 346, 355 (W.D. Va. 1968).

128. Priv. Ltr. Rul. 92-080-28 (Nov. 27, 1991).

to Revenue Ruling 69-383[129] as the source of the notion that a joint venture between an exempt and a non-exempt entity may be disqualifying. In that ruling, a troublesome joint-venture relationship was listed as one factor not present in the case under consideration, but which might be a problem if encountered in another contingent compensation arrangement. The two cases cited in this part of the Service's argument include one clear insider/controller situation[130] and one case considering a compensation scheme that raises disguised dividend concerns.[131]

Just because the IRS is asserting private inurement and private benefit as the basis of its action against United Cancer Council does not mean that the entire universe of private inurement and private benefit cases are legitimate sources for phrases, rules, and principles by which to decide the UCC case. First, despite IRS comments in the Trial Memorandum about Watson & Hughey's control over the fundraising operation,[132] the Service has conceded that Watson & Hughey was not a controlling insider in the sense that that term is used in the "bleeding off" variety of private inurement situations. Furthermore, reports of testimony at trial give no indication that the Service attempted to establish that

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129. Rev. Rul. 69-383, 1969-2 C.B. 113.

130. Stevens Bros Found. v. Commissioner, 39 T.C. 93 (1962).

131. Lorain Ave. Clinic v. Commissioner, 31 T.C. 141 (1958).

132. IRS Trial Memorandum for United Cancer Council, Inc. v. Commissioner, *reprinted in* TAX NOTES TODAY, Aug. 20 1992 at 170.

Watson & Hughey controlled UCC.[133] Therefore, the only way to find private inurement in the UCC-Watson & Hughey arrangement is to uncover a relationship between the two parties that is tantamount to stock ownership.[134] Furthermore, the same absence of control of UCC by Watson & Hughey makes the first category of private benefit cases generally inapposite. Cases in the second category of private benefit are also basically irrelevant to resolution of the UCC case, because this category is concerned with the breadth, indefiniteness, and charitable nature of the class the organization seeks to benefit, and is basically an inquiry into the purpose for which the organization is operated.[135]

Only the third category of private benefit cases plainly provides a legitimate pool of principles upon which to base a satisfactory resolution of the UCC case. Beyond these, we can legitimately look to rules and principles drawn from the other categories, but only the rules and principles of these cases that can justifiably be extrapolated to the case of outsider benefit, that is, only those rules and principles that are not hinged on control of the organization by the benefiting parties. Because the Service has suggested that the structure of the UCC-Watson & Hughey deal is tantamount to a joint venture, it makes sense to look with particular care at cases that have implicated that factor.

FINDING THE TRUE PATH

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133. Reports on testimony from first phase of the United Cancer Council trial. TAX NOTES TODAY Aug. 21, 1992 at 6 and Aug. 21, 1992 at 3.

134. *See* text accompanying *supra* notes .

135. *See supra* notes and accompanying text; Aid to Artisans, Inc. v. Commissioner, 71 T.C. 202, 215 (1978).

The questions upon which the resolution of the UCC case ought to rest are (1) whether the UCC-Watson & Hughey agreement can fairly be called a joint venture; (2) if it was a joint venture, whether it had the characteristics that make a joint venture problematic (because not all joint ventures are); and (3) if it was not a joint venture, whether it was problematic nevertheless because it put UCC in the position of serving private benefit instead of public benefit. There appears to be no clear framework for answering these questions, in part because the joint venture and Category 3 private benefit cases quite often mix together the discussion of questions (1),(2) and (3).

From the joint venture cases, one would hope to derive some principled way to tell whether the UCC-Watson & Hughey fundraising endeavor ought to be treated as a joint venture. A partnership is clearly a joint venture for purposes of this analysis, but formally constituted partnerships are not the only kind of arrangements that invoke a joint venture inquiry in the tax exemption context. The Service has asserted that "joint ventures may take a variety of forms," including "contractual agreements to cooperate in providing services."[136] Clearly, however, not every contractual arrangement between an exempt organization and a non-exempt entity is a joint venture. There are precious few clues to point the way to distinguishing the joint venture from the non-joint venture. *Stevens Brothers Foundation* presented a fairly easy case; there was a long-term pattern of joint investments, with the Foundation and other (related, non-exempt) participants contributing capital and agreeing to

136. Announcement 92-83, 1992-22 I.R.B. 59.

share the returns of the investment proportionally.[137] The difficulty involved in attributing joint venture status to an enterprise in a not-so-easy case is illustrated in General Counsel Memorandum 37259,[138] concerning an educational organization that entered into a agreement with a for-profit distributor to market a film produced by the organization. Noting that the arrangement might legitimately be classified as simply the hiring of needed expertise in the pursuit of the organization's mission, the Service concluded nonetheless that the arrangement was a joint venture. It seems safe to say that allocation of returns according to some percentage formula is central to the idea of a joint venture, although not every percentage-based deal is a joint venture.[139] Fixed return is not characteristic of a joint venture relationship -- profit-sharing is key. In this regard, it seems important to remember that the Watson & Hughey contract, though not fixed in total amount, was not tied to a percentage of returns, but rather to a per piece fee.

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137. 39 T.C. 93 (1962). The other case cited in the IRS Trial Memorandum as being a joint venture case, Lorain Ave. Clinic, 31 T.C. 141 (1958), seems more properly classifiable as a private inurement situation, as it is concerned with compensation structured as distribution of net income.

138. Gen. Couns. Mem. 37,259 (Sept. 19, 1977).

139. *See, e.g.*, National Foundation, Inc. v. Commissioner, 13 Cl. Ct. 486 (1987), for the Tax Court's rejection of the Services argument that this factor alone makes a co-venture. HARRY G. HENN AND JOHN R. ALEXANDER, LAWS OF CORPORATIONS 106 (3d ed. 1983) provides the following guidance:

> There is some difficulty in determining when the legal relationship of joint venture exists, with authorities disagreeing as to the essential elements. Most would agree on the following: (a) Agreement (express or inferred); (b) Joint interest (contribution); (c) Sharing profits (and usually losses -- unlimited liability); (d) Mutual right to control. Others would add fiduciary relationship and right to an accounting, but these are usually treated as consequences rather than prerequisites. Sharing of losses and mutual right to control are not always emphasized in these cases.

An additional dimension, which seems to have been the decisive factor in GCM 37259, is whether the magnitude of the return to the non-exempt party is tied to performance of the specific functions for which the non-exempt party has responsibility, or to the broader success of the exempt organization. In the case of the educational organization and the film distributor, the deciding factor for the IRS was that the amount of return that the distributor's percentage deal would generate was less dependent on how well the firm marketed the film than on how good a job the educational organization had done in producing the film. This inquiry has also been a part of the analysis of non-joint venture situations, particularly evaluations of profit-sharing plans and other contingent compensation arrangements.[140] In the UCC case, this factor is hard to pin down. Clearly, Watson & Hughey's compensation was based on the particular job the firm was hired to do; had UCC been the beneficiary of a large bequest during the Watson & Hughey years, for example, Watson & Hughey would not have had any claim to any part of it. On the other hand, during the years of the Watson & Hughey contract, UCC had virtually no other income to keep *or* share. Still, it is not clear that this characteristic should either classify the arrangement as a joint venture, classify it as a disqualifying joint venture, or classify it as a non-joint venture pursuit of private benefit. In a recent ruling considering whether an exempt day care center that proposed to turn over virtually its entire operation and the revenues therefrom to a for-profit management company, the IRS raised neither the possibility that the situation would be a joint venture nor the possibility that it would generate unwarranted private benefit.[141]

140. *See, e.g.*, ____.

141. *See supra* note and accompanying text.

Does it matter whether the UCC-Watson & Hughey arrangement is a joint venture? A finding that an exempt organization was participating in a joint venture was at one time decisively disqualifying.[142] However, since the IRS has abandoned the per se approach to joint ventures, the consequences of one classification or the other have become far less divergent. If the enterprise is classified as a joint venture, the task of deciding whether it is disqualifying would presumably follow the "two-part test" currently applied by the Service when it evaluates exempt organization participation in partnerships.[143] For purposes of the UCC situation, the second part of the second part of the test would presumably be most important.[144] That element asks whether the non-exempt partners benefit unduly from the arrangement. Although the Service sometimes casts this element in terms drawn from private benefit doctrine, in the context of a joint venture it is really a private inurement concern. Partners and other joint venturers have a connection with the exempt organization that raises the danger that they will benefit solely because of their relationship with the organization,

142. For a history of the evolution of the Service's approach to exempt organization participation in partnerships, see BRUCE HOPKINS, *supra* note __ at 1003-11; James J. McGovern, *The Tax Consequences of a Charity's Participation as a General Partner in a Limited Partnership Venture*, 29 TAX NOTES 1261 (1985).

143. The two-part test looks first at whether the charitable organization is serving a charitable purpose by means of the partnership. The second part of the test looks at (1) whether the charitable organization/general partner is isolated from day-to-day responsibilities as general partner, and (2) whether the limited partners are receiving an undue economic benefit from the partnership.

144. This element would be key because to disqualify UCC on the basis of the first element would seem to require a conclusion that raising money for charity is not charity, an assertion seemingly foreclosed by the Schaumberg line. The second element seems inapplicable in this situation, because it reflects particular concerns raised when an exempt organization serves as the general partner of a limited partnership.

because of the fiduciary duty owed by one co-venturer to another.[145] Reasonability of return to the non-exempt co-venturer is a part of this inquiry, as it ought to be; unreasonable financial benefit is a central part of the "bleeding off" variety of private inurement analysis.

If the UCC-Watson & Hughey arrangement cannot be called a joint venture, the reasonability of the terms of the contract may or may not play an important role in arriving at a holding in the case. While some mention of whether the non-exempt party's side of the deal is reasonable is often made in Category 3 private benefit cases, the IRS is more likely to mention this element than are the courts, and the element is more often mentioned in passing in dictum than relied upon to reach a result.[146] The source of the idea can be traced back to Revenue Ruling 69-383. There, the reasonability of compensation, despite the fact that it was percentage-based, seems to have been a factor in deciding that the arrangement was not a way to distribute earnings. The fact that the individual at issue in that situation had no control over the organization was also key. Thus, it seems that Revenue Ruling 69-383 may really have been about reassurance that private inurement was not present in spite of the fact that employee compensation was cast in terms of percentage of organizational income.

One cannot say that whether the outsider's side of the deal is reasonable plays no part in the evaluation of Category 3 private benefit concerns. However, it is fair to say that

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145. It was tension between this fiduciary duty and an exempt organization's duty under tax exemption law to pursue its exempt purposes that underlay the Service's original per se approach to exempt organization participation in partnerships and that continues to underlie the two-part (really three-part) approach to partnerships currently followed. *See* HARRY G. HENN AND JOHN R. ALEXANDER, *supra* note __ at 107.

146. *See* Senior Citizens of Missouri v. Commissioner, 56 T.C.M. (CCH) 480 (1988); Rev. Rul. 69-494; Gen Couns. Mem. 37,259; Gen. Couns. Mem. 36,311; Gen. Couns. Mem. 34,256.

reasonability of terms is often mentioned in tandem with observations about whether the benefited party exerts any control over the exempt organization.[147] Most of the pronouncements (even those that make a flat statement that reasonability of the deal is a threshold condition), like Revenue Ruling 69-383, note that the deal was reasonable and the deal makers without control over the organization. None seems to say, although the deal constitutes an arm's length transaction, the terms were not reasonable, so the exemption must fall. It is notable that the cases and IRS rulings that most parallel the UCC-Watson & Hughey arrangement (assuming that it cannot be shown that Watson & Hughey in fact controlled UCC, in which case the standard private inurement analysis is apposite) tend not even to consider the possibility that the arrangement is a joint venture or that the reasonability of the terms ought to be considered.[148] In a few cases, reasonability is mentioned, but the point is made that the particular exigent circumstances involved in the situation justify what look like a high proportion of return directed to the non-exempt participant.

Should reasonability of the reward reaped by the non-exempt party be an element of deciding whether disqualifying Category 3 private benefit is present in an organization's operations? Whereas it is clear that reasonability is a legitimate part of private inurement analysis, it is not so clear that it belongs in an analysis of whether Category 3 private benefit is present. The concept is borrowed from the private inurement context, where it helps to

147. Again, where there is control, reasonability of return is clearly important as a factor of private inurement analysis.

148. Science & Research Found., Inc. v. Commissioner, 13 Cl. Ct. 486 (1987); Goldsboro Art League, Inc. v. Commissioner, 75 T.C. 337 (1980); Rev. Rul 73-45; Rev. Rul. 67-302 (implies that control or absence of control is relevant to reasonability issue).

screen for the duty of loyalty violations that offend the inurement proscription. But duty of loyalty issues are not raised by deals with outsiders. Apparently unreasonable terms in an exempt organization's dealings with outsiders should certainly trigger close scrutiny to determine whether the outsiders are truly outsiders and, if they are not, to analyze the deal in private inurement terms. To insist upon reasonable terms in the dealings of exempt organizations with truly unconnected outside parties, however, seems to incorporate a duty of care element into section 501(c)(3). The IRS approach in the United Cancer Council case threatens to go in this direction. The cases upon which the Service relies in the Trial Memorandum[149] each involved an exempt organization's dealings with its controllers, and are less apposite to the UCC situation than is Science and Research Foundation,[150] which those cases make a point of distinguishing, or Broadway Theatre League of Lynchburg[151] or Plumstead Theatre Society.[152] What distinguishes the United Cancer Council arrangement with Watson & Hughey from Plumstead, Broadway Theater League, and Science and Research Foundation is that the deals in those cases turned out better and that they were arguably more carefully and competently arrived at to begin with. The recent day care ruling discussed shares this feature; the Service notes (without explaining how it arrives at the conclusion) that the terms of the contract are "reasonable," and chronicles the care taken in

149. People of God Community v. Commissioner, 75 T.C. 127 (1980); World Family Corp. v. Commissioner, 81 T.C. 958 (1983); est of Hawaii v. Commissioner, 71 T.C. 1067 (1979).

150. 181 F. Supp. 526 (S.D. Ill. 1960).

151. 293 F. Supp. 346 (W.D. Va. 1968).

152. 74 T.C. 1324 (1980).

arriving at the arrangement.

In a thoughtful 1971 General Counsel Memorandum (trying to grapple with what the rules are about limits on "business" activity and accumulation of assets by charitable organizations), the IRS made reference to the fact that the tax law incorporates "rules rooted in the general law of charity respecting the duties imposed on fiduciaries in the administration of charitable properties. . . . All of those rules center on the single basic principle. . . that charity property must be administered exclusively in the beneficial interest of the charitable purposes to which it is dedicated." The GCM goes on to note that there are two strands to this concept -- in essence, the duty of loyalty and the duty of care. It further notes that the IRS has "seldom, if ever, attempted to regulate compliance with either of them as conditions of charitable qualification for federal income tax purposes."[153] This discussion both suggests that duty of care is inherent in section 501(c)(3) and acknowledges that the IRS has recognized that it is ill-suited to evaluate this aspect. Enactment of specific duty of care-related rules to apply to private foundations in 1969 indicates that Congress, too, believed that duty of care standards ought not to be thought to lurk between the lines of section 501(c)(3). Perhaps it makes sense to activate duty of care notions within section 501(c)(3). But pursuing duty of care failures through exemption law would seem to create more problems than it would solve. While serving a selfish interest is the antithesis of common law charity, serving the public interest ineptly just doesn't have the same ring. Perhaps most disturbing, building a duty of care inquiry into exemption decisions invites IRS judgments about such things as

153. Gen. Couns. Mem. 34,682 (Nov. 17, 1971).

unwise administrative costs[154] and, ultimately, anything that might be seen as doing good badly. Certainly, we should not go down this path without clearly acknowledging what we are doing.[155]

There may be other ways to understand the various factors that have played into Category 3 private benefit cases and those that are at work in United Cancer Council. One thought is that a truly unreasonable deal, even with a true outsider, results in a sort of "halo lending" by the exempt organization that is inconsistent with continued exemption. Certainly this notion is an underlying theme through much of tax exemption law, although it is generally an undercurrent, surfacing only through established rules and doctrines, such as private inurement, Category 1 private benefit cases, and inappropriate joint venture structure cases. Identifying this as the sorting principle for approaching Category 3 private benefit cases would at least focus the inquiry on situations that involve money changing hands, and would not run as much risk of planting for future harvesting phrases that can reach well beyond where the IRS ought to go. The danger, of course, is that it may be as difficult to construct a principled framework to guide IRS decisions about when a halo has been shared inappropriately as it is to steer the Service's judgments about breaches of duty of care.

In any case, the United Cancer Council case should not be decided on the terms in

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154. The IRS has signaled that it may not consider administrative functions of a charitable organization to be charity. *See, e.g.*, the IRS position in Council for Bibliographic and Information Technologies v. Commission, T.C. Memo 1992-364 (1992); Rev. Rul. 74-614, 1974-2 C.B. 164; Rev. Rul. 81-29, 1981-1 C.B. 329.

155. It should also be remembered that, whether or not the IRS gets into the duty of care business, the states are already there. If the worry is that the states are incapable of responding adequately to breaches, there may be better responses than inviting the IRS in.

which it has, so far, been cast. Mining phrases from past private inurement and private benefit cases without carefully considering what they mean and where they came from can only add to the confusion.