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TAX FAVORS FOR PHILANTHROPY: SHOULD OUR REPUBLIC UNDERWRITE DE TOCQUEVILLE'S DEMOCRACY?

Rob Atkinson*¹

This article critically reviews the current rationales for the federal income tax system's favorable treatment of philanthropy, gives those rationales a new descriptive synthesis based on de Tocqueville's account of American democracy, and offers a normative alternative based on neo-classical ethical and political theory. It first identifies

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¹ I am grateful to New York University's National Center on Philanthropy and the Law, particularly to Harvey Dale and Jill Manny, for the opportunity to present "Shades of Virtue: Measuring the Comparative Worthiness of Charities," at NCPL's 21st annual conference on October 29 and 30, 2009. Alexandra Akre provided superb research assistance.

the two basic normative questions: What is the function of philanthropy that warrants favorable tax treatment, and how well does favorable tax treatment advance that function? It then examines the answers of three distinct phases of normative tax theory: the traditional subsidy thesis, the antithetical technical definition of income theory, and a set of synthetic theories that combine elements of both prior theories. That review reaches a paradoxical conclusion. Although the charitable exemption and deduction are perhaps impossible to justify in any other way, together they almost perfectly co-ordinate three basic features of American society: the populist and anti-statist sources of American philanthropy, the consumerist orientation of our form of market capitalism, and our tax system's reliance on income as its principal revenue source. Finally, this paper outlines an alternative, neo-classical justification for favoring philanthropy, grounded in both the constitutional values of justice and general welfare and the ethical and political theories of Plato and Aristotle.

The citizen of the United States is taught from infancy to rely upon his own exertions in order to resist the evils and the difficulties of life; he looks upon the social authority with an eye of mistrust and anxiety, and he claims its assistance only when he is unable to do without it. This habit may be traced even in the schools, where the children in their games are wont to submit to rules which they have themselves established, and to punish misdemeanors which

they have themselves defined. The same spirit pervades every act of social life.

Alexis de Tocqueville, *Democracy in America*²

We the People of the United States, in Order to form a more perfect Union, establish Justice, insure domestic Tranquility, provide for the common defense, promote the general Welfare, and secure the Blessings of Liberty to ourselves and our Posterity, do ordain and establish this Constitution for the United States of America.

Preamble, The Constitution of the United States of America

I. INTRODUCTION: FINDING THE PROPER FOUNDATION FOR AMERICAN PHILANTHROPY

Tax theorists have long debated the rationales for the federal income tax system's favorable treatment of philanthropy.³ The debate has certainly become more

² Alexis de Tocqueville, *Democracy in America*, Ch. 12, University of Virginia Hypertexts Project, http://xroads.virginia.edu/~HYPER/DETOC/1_ch12.htm (accessed March 8, 2010).

³ The terms "philanthropy" and "charity" are, in common parlance, synonyms. In modern American law, particularly federal income tax law, "charity" is the more commonly used term and, for that reason, I use it in specific reference to the Internal Revenue Code. But "philanthropy" generally suits this project much better. Most importantly, "philanthropy" has the advantage of its etymology, "love of humankind." "Charity," on the other hand, has lost much of that

sophisticated, but it has nonetheless failed to produce anything near full convergence of opinion. This article reviews that debate and reaches a paradoxical conclusion. Although the present system of exemption and deduction is perhaps impossible to justify in any other way, that system almost perfectly coordinates three basic features of American society: the populist and anti-statist sources of American philanthropy, the consumerist orientation of our form of market capitalism, and our tax system's reliance on income as its principal revenue source.

To say that the Internal Revenue Code's (hereinafter "Code") treatment of philanthropy accommodates these three features well, however, is not to say that any of them is itself good. As an alternative to the current system's fundamental populism and consumerism, this paper proposes a neo-classically republican view of the public good, grounded in the constitutional values of justice and general welfare. Philanthropy's core function will be to promote those values. This, in turn, implies not only a very different tax treatment of philanthropy, but also a very different relationship between philanthropy and the state. The Code implicitly endorses the philanthropy of Jacksonian democracy and consumerist capitalism; the philanthropy of both Jefferson and Lincoln's republicanism would look quite different (and much more like that of Plato's Republic and Aristotle's Ethics and Politics). It

connotation, despite its eloquent expression in Paul's Second Epistle to the Church at Corinth.

would better fit both the neo-classically republican elements of our constitutional culture and what Lincoln called “the better angels of our nature.”⁴

Part I takes up the two basic questions that any normative theory of the Code’s favorable treatment of philanthropy must answer: What is the function of philanthropy that warrants favorable tax treatment (the worthiness question), and how well does favorable tax treatment advance that function (the fit question)? It examines the answers of three distinct phases of exemption and deduction theories: the traditional thesis that the exemption and deduction are subsidies of the public benefits that philanthropies provide; the antithetical view that exemption and deduction are not subsidies, but artifacts of a proper definition of the income of philanthropies and their donors, respectively; and a set of synthetic theories that ground the exemption and deduction, not in the particular goods philanthropies or their donors provide, but rather in the special ways that philanthropies provide any kind of good or service. On first face, as we will see, all these accounts disappoint.

The traditional subsidy theory, elaborated in the 1970’s, has set the terms of the debate ever since. The theory offers an intuitively appealing invocation of public benefits as the rationale for supporting philanthropy through the tax system, but that rationale poses three

⁴ President Abraham Lincoln, Inaugural Address (Mar. 4, 1961), available at http://avalon.law.yale.edu/19th_century/lincoln1.asp.

persistent problems. With respect to the worthiness question, it fails to provide a meaningful measure of the public benefits philanthropies are supposed to provide. On the fit question, it gives little reason to think that tax subsidies appropriately promote philanthropies' publicly beneficial functions. And it leaves a serious Constitutional question unanswered: How, consistent with the Establishment Clause, can the federal government subsidize religion, a recognized form of charity, in both the exemption and the deduction? The other two sets of theories – the definition of income theory and the synthetic theories – ultimately prove to be unsuccessful, if extremely clever, efforts to address (or dodge) these three basic questions.

But, as Part II explains, the central insights of both these critiques of traditional subsidy theory, taken together, let us see the traditional subsidy theory in an entirely different and much more favorable light. If, following the technical definition theory, we see the exemption as an exclusion from the tax base, then its crudeness as a subsidy seems inevitable, though hardly ideal. The insights of the meta-benefit theories are more positive and much more significant. Following their lead, we can see the traditional subsidy theory's failure to specify the public benefits philanthropies provide as pointing to a strength, rather than a weakness, of the Code's favorable treatment of philanthropy.

In both a capitalist market economy and a liberal democratic polity, value agnosticism on the part of the state

is a virtue, not a vice. The Code, with all the sophistication of a post-modern philosopher, eschews identifying any objective criteria of public benefit. Instead, it grants favorable tax status to virtually any nonprofit, non-state organization that gives consumers what they cannot get in the market and voters what they cannot get from the state. In this respect, the Code's treatment of philanthropy nicely meshes with the standard theory of philanthropy as the response of voters and consumers to particular kinds of market and government failure. Under the standard theory of its function, the philanthropic sector provides consumers and voters with what the market and the government, by their own standards, fail to provide or, more precisely, fail to provide well. The tax system, on this view of the traditional subsidy theory, gives this supplemental sector a suitable supplement of its own.

And this subsidy also nicely complements de Tocqueville's view of why Americans prefer philanthropic suppliers over government: We strongly prefer private to state provision of goods and services, we profoundly favor donative financing to "taxing and spending," and we generously tolerate others' ideas about what the public good is and how it should be advanced (as long as they are willing to do it themselves, with their own resources).

But, as Part III will remind us, giving people what they want, the defining function of populist democracy and consumerist capitalism, is not the sole goal of the American republic and not the primary goal of one of its foundations, classical political and ethical theory. Although

supplementing the market and the state in serving that goal is the function of philanthropy under the predominant academic theory, it is not the traditional understanding of philanthropy. Building on these points, Part III proposes a neo-classically republican understanding of philanthropy, which in turn implies both a very different tax treatment of philanthropy and a very different relationship between philanthropy, the state, and the market.

II. THE TRADITIONAL SUBSIDY THEORY AND ITS CRITICS

This part critically reviews the normative theories of the exemption of charities' income and the deductibility of taxpayers' charitable gifts. Following not just these theories, but also the Code itself, this overview gives precedence to charities' income exemption, treating donors' gift deduction as subordinate, if not derivative. Without too much tugging and hauling, theories of both the exemption and the deduction fit into a quasi-Hegelian sequence of thesis, antithesis, and synthesis: the traditional subsidy theory, the antithetical definition of income theory, and the synthetic meta-benefit theories.⁵

A. THESIS: THE TRADITIONAL SUBSIDY THEORY

The conventional wisdom about the Code's treatment of charity is more often quoted than questioned,

⁵ See Rob Atkinson, "Theories of the Federal Income Tax Exemption for Charities: Thesis, Antithesis, and Syntheses," 27 STETSON L. REV. 397 (1997).

even today.⁶ The charitable income exemption and gift deduction are two sides of the same coin, an indirect subsidy of the public benefits that charities⁷ and donors, through charities, provide (e.g. health care, education, and relief from poverty or disaster). The implicit rationale runs like this: charitable organizations, charitable donors, and the government are all in the business of benefitting the public. It makes sense, then, for the government to help charities and their donors do their good works with a subsidy through the tax system.

This approach has deep intuitive appeal and, as we shall see in Part II, something approaching pragmatic genius. For one thing, it maps nicely onto the two functions with which liberal democratic governments have the most trouble, redistributing wealth and promoting specific forms of private consumption, and yet to which our state, like all its modern counterparts, is committed.⁸ The benefits

⁶ See John Simon, Harvey Dale, & Laura Brown Chisolm, *The Federal Tax Treatment of Charitable Organizations*, in THE NONPROFIT SECTOR 267, 274 (Walter Powell & Richard Steinberg, ed., 2006) [hereinafter Federal Tax Treatment] (“The most traditional of the normative arguments for a subsidy theory holds that exemption and deductibility are needed to promote the provision of certain kinds of benefit to the public.”).

⁷ I use “charity” rather than “philanthropy” here to track the language of the code and most of its commentators; for my reasons for preferring “philanthropy,” see note 3, *supra*.

⁸ See Rob Atkinson, *Re-Focusing Philanthropy: Revising and Re-Orienting the Standard Model*, 4 WM. & MARY POL’Y REV. 1, 14-51 (2012) (identifying four basic government functions: the Ricardian

provided by charities, on this view, fall nicely into two general groups: ordinary, garden variety goods like food, clothing, and shelter to the especially needy, and especially good goods like art and education to anyone.⁹

What is more, the kinds of activities recognized as charitable by the traditional subsidy theory also correspond quite nicely to both the Code and the common law's definitions of charity, which themselves generally reflect our society's sense of what charity really is and does. Indeed, this correspondence is built into both definitions. The common law definition of charity lists a number of specific headings, then a general catchall category of other purposes "beneficial to the public."¹⁰ The Code's definition has the same structure; its residual category is simply "charitable," which the courts have held to incorporate the common law's "beneficial to the public" standard.¹¹

(maintaining minimum conditions for a market economy), the Regulatory (ensuring the efficiency of markets), the Redistributive (redistributing wealth), and the Aretist (promoting production and consumption of superior products)).

⁹ See Rob Atkinson, *Altruism in Nonprofit Organizations*, 31 B.C. L. REV. 501, 605. See also Federal Tax Treatment, *supra* note 6 (citing Atkinson for this distinction). These two purposes, helping the needy and providing especially good goods, almost perfectly match what I have described elsewhere as the redistributivist and aretist functions of the state. See Atkinson, *supra* note 5.

¹⁰ *Commissioners for Special Purposes of the Income Tax v. Pemsell*, [1891] App. Cas. 531, 583 (H.L.).

¹¹ See *Bob Jones Univ.*, 461 U.S. at 574; Treas. Reg. § 1.501(c)(3)-1(d)(2).

Despite its intuitive appeal, the traditional subsidy theory presents three severe problems: the tension between state support of religion and the Constitution's Establishment Clause, a question-begging definition of charity, and a dubiously indirect means of supporting charity. We need to take up each of these problems in turn.

*1. The First Amendment Problem:
Subsidizing Religion*

Recognizing religion as a charity poses this dilemma: On the one hand, religion was a traditional charitable purpose under the common law; on the other hand, the First Amendment's Establishment Clause severely restricts all levels of our government in their support of religion. If, as traditional theory assumes, the charitable exemption and deduction are subsidies, then they are in considerable tension with the limits of the Establishment Clause.¹² As a matter of law, the Supreme Court has eliminated this dilemma: even if these special tax treatments are subsidies, this kind of subsidy does not violate the Establishment Clause.¹³ As a matter of both law and theory, however, the basis for this conclusion is anything but clear.¹⁴ Neither the Court nor commentators

¹² Federal Tax Treatment, *supra* note 6, at 276.

¹³ *Walz v. Tax Comm'n*, 397 U.S. 664 (1970). As Simon, Dale, and Chisolm point out, however, similar issues may yet arise under the equal protection clause. Federal Tax Treatment, *supra* note 6, at 276.

¹⁴ *Walz*, 397 U.S. at 704 (Douglas, J., dissenting) (insisting that exemption is a subsidy). *See also* *Regan v. Taxation with Representation*, 461 U.S. 540 (1983) (noting that exemption and direct

have given an entirely convincing account of why government's subsidizing of religion through the tax code is not a form of favoring religion forbidden by the Establishment Clause.

*2. The "Worthiness" Problem: Ambiguity
About Public Benefit*

The vagueness of the traditional theory's general definition of charity is a much bigger problem, in both principle and practice. That definition neither tells us what makes the specific, listed purposes publicly beneficial nor gives us any criterion for determining what additional purposes might qualify under the catchall category of "beneficial to the public."¹⁵ The source of the problem seems to be this: the traditional theory assumes a monolithic view of the public good. Given the common law origins of the legal definition of charity, this would be an easy mistake to make. Both the common law definition and the supplementary Statute of Elizabeth¹⁶ were products of a state that was neither democratic nor particularly liberal and a culture that was much less pluralistic than ours. "Public benefit," in that context, would likely have been

subsidies are not "in all respects identical," but ignoring the difference for purposes of deciding the case).

¹⁵ This reflects, in turn, a basic problem with the state's redistributive and redistributionist functions: they do not imply their own qualitative criteria, and, without some such criterion, we cannot develop any useful quantitative standards. See Atkinson, *supra* note 8, at 14-51.

¹⁶ An Act to Reform Deceits and Breaches of Trust Touching Lands Given to Charitable Uses, 1597, 39 Eliz. c. 6. (Eng.).

associated with natural law philosophy, Christian theology,¹⁷ or statist politics; public benefit could either be rationally demonstrated or, more likely, simply associated with the good of the state.¹⁸

As the special case of religion nicely illustrates, however, that approach cannot work well in our pluralistic culture and liberal democratic polity. Unlike Tudor England, of course, we have no national church. What is more, our legal definition of charity clearly distinguishes, more generally, between state purposes and the larger category of publicly beneficial purposes.¹⁹ As a democracy limited by liberalism and a culture committed to pluralism,²⁰ we do not equate public benefit with majority

¹⁷ See *Commissioners for Special Purposes of the Income Tax v. Pemsel*, [1891] App. Cas. 531, 583 (H.L.) at 580 (associating charitable purpose with “the piety of earlier times”).

¹⁸ See Matthew Turnour, *BEYOND CHARITY: OUTLINES OF A JURISPRUDENCE FOR CIVIL SOCIETY* 331-48 (dissertation submitted for doctorate of philosophy, Queensland University of Technology, Sept. 23, 2009) [hereafter *Beyond Charity*] (“The factors informing the drafting of the Preamble [of the Statute of Elizabeth] are not relevant in twenty-first century common law countries, but the consequences are.”).

¹⁹ See *Bob Jones Univ. v. U.S.*, 461 U.S. 574 (1983) (Powell, J., concurring); see also *Treas. Reg. § 1.501(c)(3)-1(d)(2)* (discussing “relieving the burdens of government” as a distinct charitable purpose).

²⁰ See, e.g., Albert M. Sacks, *The Role of Philanthropy: An Institutional View*, 46 VA. L. REV. 516, 524 (1960) (citing “initiative of thought and action,” “diversity of views and approaches,” and “experimentation in new untried ventures”).

interests.²¹ But if public benefit is neither shouldering the burdens of government nor serving the majority's will, then what is it?

Both treasury regulations and recent cases refer us to the evolving common law concept of charity,²² but that begs rather than answers the question. Unless we are to return to ad hoc applications of the chancellor's proverbial foot, the evolution of the common law concept of charity must itself be guided by an identifiable and articulated standard of public benefit. Both liberal economic theory, which is agnostic towards the "goodness" of particular goods, and liberal political theory, which is neutral toward competing conceptions of the social good, offer little help in specifying public benefits.²³ To cloak the charitable tax exemption in the garb of "public benefit" without saying more about the cloth from which it is cut invites the suggestion that the Code's exemption categories are nothing more than naked political preferences or a crazy quilt of unprincipled, ad hoc determinations.

Even if the traditional subsidy theory could deliver a general definition of public benefit, it would then face another problem: it proves too much. If particular goods and services are publicly beneficial and thus worthy of

²¹ See Charles Reich, *The New Property*, 73 Yale L.J. 733 (1964) (describing the "great error" of equating public interest with majority interest).

²² See *Bob Jones Univ.*, 461 U.S. at 574; Treas. Reg. § 1.501(c)(3)-1(d)(2).

²³ See Atkinson, *supra* note 8, at 14-51.

subsidization through tax exemption, why shouldn't the subsidy extend to for-profit producers of the same products?²⁴ The closest traditional theory comes to an answer is the suggestion that charitable provision of goods and services promotes a second kind of public benefit, a kind of "meta-benefit." These secondary benefits derive not from what product is produced or to whom it is distributed, but from how a product is produced or distributed. Traditional theory pointed, always a bit vaguely, to such "meta-benefits" as "diversity," "pluralism," "innovation," and "efficiency."²⁵ But to point to these meta-benefits is to raise an obvious question: Are those not precisely the values served by a capitalist market economy that is supplemented by a liberal democratic polity?

3. *The "Fit" Problem: Fiscal Inefficiency of*

²⁴ See Henry B. Hansmann, *The Rationale for Exempting Nonprofit Organizations from Corporate Income Taxation*, 91 YALE L.J. 54, 67-68 (1981) [hereinafter *Exempting Nonprofit Organizations*]; see also BURTON WEISBROD, *THE NONPROFIT ECONOMY* 30 ("There is no necessary reason that subsidies should work only through nonprofit organizations."); Mark Gergen, *The Case for a Charitable Contributions Deduction*, 74 VA. L. REV. 1393, 1410 (1988) ("If a good may be provided through the market, that mechanism promotes novelty and experimentation just as well.").

²⁵ See Federal Tax Treatment, *supra* note 6, at 274 ("Traditional subsidy theory also recognizes secondary benefits – such as innovation, experimentation, efficiency, and initiative – that are said to arise from the very fact that goods and services are provided by organizations that are not constrained by the usual market forces or electoral accountability.")

Tax Expenditures

The second problem with the traditional subsidy theory, its lack of a general definition of charity, like the traditional theory's first problem, its favorable state treatment of religion, is a problem of charity's purpose, defining legitimate ends for charity to serve and for the state to subsidize. The final problem with the traditional subsidy theory has to do with the means by which the state is to advance these ends: favorable tax treatment. This is a problem we might refer to as fiscal efficiency. As we have seen, the traditional theory assumes that charities' special tax treatments are, in effect, government subsidies. As such, they amount to "tax expenditures," indirect public payments for the goods and services charities provide. Viewing exemption and deduction as tax expenditures raises a troubling question: Could we not get more "bang" for our revenue "buck" by making the subsidy to charities directly, as a true subsidy, rather than indirectly, as a tax expenditure?²⁶

And, even if tax expenditures were more appropriate than direct subsidies in the case of charity, the current system of exemption and deduction would still seem a pretty poor fit. Neither the exemption nor the deduction is particularly well correlated with the amount of "good" charity does, whatever that "good" is. Hansmann

²⁶ See generally STANLEY SURREY, *PATHWAYS TO TAX REFORM: THE CONCEPT OF TAX EXPENDITURES* (1973); STANLEY SURREY & PAUL R. MCDANIEL, *TAX EXPENDITURES* (1985).

points out that a subsidy by way of income exemption is proportional to retained earnings and questions whether that linkage is justified. In his view, “there is no reason to expect a positive correlation between the amount of a nonprofit's retained earnings and the factors ... that might justify a subsidy.”²⁷

Harvey Dale captures this point nicely in a parable he tells to the graduate tax mavens at NYU (a pearl he generously, if not wisely, cast in my direction as well): Suppose someone in the market for legal advice came upon two equally qualified lawyers and offered to pay them based upon their respective net worth. This would strike us as odd, because net worth has little correlation with the services to be performed—as little, the parable suggests, as a subsidy to charities through the tax system has with the social benefits charities provide. And the point of the parable is all the more penetrating when backed by the force of arguments about the fiscal inefficiency of tax subsidies.

Traditional subsidy theory addresses the fit between ends and means rather indirectly, sometimes suggesting that tax exemption is the only politically feasible or

²⁷ Exempting Nonprofit Organization, *supra* note 24, at 71. See also Mark A. Hall & John D. Colombo, *The Charitable Status of Nonprofit Hospitals: Toward a Donative Theory of Tax Exemption*, 66 WASH. L. REV. 307, 374 (1991) [hereinafter *Charitable Status*]; Mark A. Hall & John D. Colombo, *The Donative Theory of the Charitable Tax Exemption*, 52 OHIO ST. L. REV. 1379, 1389-98 (1991) [hereinafter *Donative Theory*].

practically administrable form of subsidy to charity, sometimes (perhaps making a virtue of necessity) hailing the very indirectness of the subsidy as a salutary stimulus to pluralism and decentralized decision-making.²⁸ This seems rather too glibly to discount the importance of the fit issue. But to be glib is not necessarily to be wrong. As Part II will show, after all the arguments for a tighter fit are given their due, looseness of fit may be an inevitable, if not entirely desirable, element of the exemption, as the traditional subsidy theory assumed.

This brings us to a more general point. All these questions, those of the means of special tax treatment and those of identification and measurement of the publicly beneficial ends of charity itself, can be answered within the framework of the traditional subsidy theory. Before we turn to those answers, however, we need to examine the ways that scholars have tried to avoid both sets of questions about traditional subsidy theory. In retrospect, the antithetical technical definition theory can be seen as an effort to dodge the question of means, even as the synthetic meta-benefit theories can be seen as efforts to dodge the question of ends. Once we see why both efforts are unsatisfactory, we can better appreciate, in Part II, the

²⁸ See BRUCE R. HOPKINS, *THE LAW OF TAX-EXEMPT ORGANIZATIONS* 7 (1987) (charities foster “voluntarism and pluralism” and decentralized, efficient decision-making and resource allocation); John G. Simon, *The Tax Treatment of Nonprofit Organizations*, in *THE NONPROFIT SECTOR* 67, 70 (Walter W. Powell ed., 1987).

answers the original subsidy theory can offer – answers we will then be in a better position to question, in Part III, from a neo-classically republican perspective.

B. ANTITHESIS: TECHNICAL DEFINITION THEORY

The antithetical technical definition theories seek to supplant the intuitive appeal of the subsidy thesis with clever corollaries of the Haig-Simon definition of income.²⁹ On this view, though the charitable exemption and deduction look on first face like indirect subsidies of “motherhood and apple-pie” charitable staples, both these code provisions prove, upon closer examination, to be no more than artifacts of properly defining the income of charities and their donors, respectively. This is the central claim: properly understood, charities ultimately have no income, even as the gifts that taxpayers give them are not properly includable in the givers’ taxable income in the first place.

After canvassing the early legislative history, Bittker and Rahdert, architects of the technical definition theory, conclude that charities and other nonprofits had been exempted primarily because the income tax could only logically be levied on activities undertaken for profit.³⁰ Bittker and Rahdert accept this nascent rationale as essentially sound and elaborate it into a full-blown

²⁹ Henry Simons, *PERSONAL INCOME TAXATION* (1938).

³⁰ See Boris I. Bittker & George K. Rahdert, *The Exemption of Nonprofit Organizations from the Federal Income Taxation*, 85 *YALE L.J.* 299, 302-04 (1976).

exemption theory. They identify two fundamental problems with taxing the income of such organizations: first, their net income cannot be made to fit under any workable tax definition of income, and second, even if it could, no appropriate tax rate could be applied to them.³¹

Bittker and Andrews, in separate but almost simultaneous articles, applied a parallel analysis to donors' income. Both conclude that donations to charity belong to a class of payments, like health care, that are not truly discretionary and that should not be counted as income subject to taxation.³² Charitable donations, though formally deductible by donors, are thus more properly seen as technical exclusions from personal income and not as policy-based preferences for charitable purposes.

This re-characterizing of the exemption and deduction as technical artifacts of properly defined charities' and individuals' income is nothing if not ingenious. This single move sidesteps all three basic problems of the traditional subsidy theory. If the exemption and deduction are not subsidies, then, at the most general level, the need to figure out what they subsidize disappears, along with the problem of the Code and the common law's vague definition of charity. What's more, removing the qualitative question of what charity is also removes, *a*

³¹ See *id.* at 307-16.

³² William Andrews, *Personal Deductions in an Ideal Income Tax*, 86 HARV. L. REV. 309 (1972); Boris Bittker, *Charitable Contributions: Tax Deductions or Matching Grants*, 28 TAX L. REV. 37 (1972). See also Gergen, *supra* note 24.

fortiori, the daunting quantitative question of how charitable any particular organization is and how much public benefit it actually provides. Similarly, if the exemption and deductions are not subsidies, then they are not tax expenditures, and the question of a superior alternative means of supporting charity also disappears. So, too, does the problem of government subsidization of religion.

For all its brilliance, however, the technical definition theory suffers two serious deficiencies of its own. The first goes to the very root of the theory itself and the second makes that theory, even if sound in principle, extremely limited in application. The first, and more fundamental, problem is this: upon closer inspection, as Henry Hansmann has shown, each step in the derivation of a supposedly technical reason for special treatment of charities' revenues and donors' charitable gifts turns out to involve substantive issues, all of which the theory answers in demonstrably tendentious ways.³³ Resolution of each of these issues takes us back, at bottom, to the basic question that the technical definition theory is designed to avoid: What is special about charitable organizations? That turns out always to be a normative, rather than merely a

³³ Exempting Nonprofit Organization, *supra* note 24, at 96. A parallel argument can be made with equal force as to the deduction. *See* Federal Tax Treatment, *supra* note 6, at 274 (noting that the making of gifts involves an element of control over wealth that is arguably inconsistent with exclusion from income under the Haig-Simons definition).

technical, question, and a normative question that the technical definition theory repeatedly begs.

The strength of Hansmann's critique of Bittker and Rahdert's theory is to point out that all the questions they raise about the definition of charities' income are technically answerable on fairly straightforward analogies to the income of for-profit firms. This might require a degree of complexity, even convolution, but these would hardly be novelties to the tax code. If we are not to extend ordinary principles of income taxation to nonprofits, we must thus look for a normative, rather than merely a technical, reason. Tiffany's net income available for distribution to its stockholders is arguably different from the Red Cross's distributions of donations to flood victims, but the two could be made subject to tax with roughly equal convenience. But again, that only poses the normative question: We could make this extension, but should we? To answer that, we must return to the basic question that the technical definition theory promised to avoid: What is it about charities that warrants our according them special tax treatment?

The inevitability of policy choices at this point can be illustrated in another way. Even if Bittker and Rahdert are right, and the charitable exemption is necessary as a matter of tax base definition, the issue of worthiness comes in through the back door. Their theory of its own force applies to all nonprofits, yet, with respect to charities, they somewhat arbitrarily limit its scope to the present reach of

I.R.C. Section 501(c)(3).³⁴ They give us no reason, consistent with their own theory, to think that these limits are appropriate. They themselves seem content with the policy choices reflected in current law. But one of the reasons they give for seeking an alternative to current law is that the asserted virtues of charity are difficult to prove.³⁵ Unless they are prepared to extend their theory, and the scope of the charitable exemption, to cover all legitimate nonprofits, they will leave us with the most basic problem they set out to avoid: how to identify the aspects of charity that make it worthy of special treatment.

The second problem with the technical definition theory is its practical applicability. The theory is not, even by its own terms, a normative account of charity at all, but an explanation of the special treatment of charity in the Code. Thus, although the theory purports to remove questions of charitability, both qualitative and quantitative, from the tax code, it does not even attempt to address those questions in other critical areas. We, as a society, would still need to know which charities warrant special treatment in other areas of law, many of which simply treat an organization's tax status as determinative.³⁶ We, as

³⁴ See Bittker & Rahdert, *supra* note 30, at 331-32.

³⁵ See *id.* at 332-33, 342.

³⁶ See generally Hansmann, *supra* note 33, at 54; see also Robert Atkinson, *Philanthropy and the Law: Remembering and Measuring the Common Good*, lead paper, NYU School of Law, National Center on Philanthropy and the Law, 21st Annual Conference, "Shades of Virtue: Measuring the Comparative Worthiness of Charities" (New York, 29

individuals, would still need to know what charities to support with our private resources and to what extent.

The technical definition theory thus leaves us, with respect to all aspects of charity except its income tax treatment, precisely where we began: looking for what is distinctively good about charity in the first place and then, beyond that, for a means of measuring that goodness.³⁷ And these are, of course, questions on which the tax treatment of charity itself depends, since the Code's definition of charity, as we have seen, tracks that of the common law. In addition to its list of particular charitable purposes, remember, the Code itself incorporates into its catchall category of "charity" the common law's own undefined residual category, "other purposes beneficial to the public."³⁸

C. SYNTHESSES: META-BENEFIT THEORIES

Hansmann's critique of Bittker and Rahdert shows that exemption is not a matter of technical necessity. It could be eliminated without doing violence to the structure of the tax system, and therefore its retention requires a substantive, not merely a formal, justification. Yet our examination of the traditional subsidy theory revealed that such a justification cannot be made in terms of merely

October 2009) (citing Harvey Dale, unpublished manuscript).

³⁷ See Federal Tax Treatment, *supra* note 6, at 267, 275 ("Within a tax-base-defining construct, the process of identifying the ideal tax base is neither easy nor value-neutral.").

³⁸ Commissioners for Special Purposes of the Income Tax v. Pemsel, [1891] App. Cas. 531, 583 (H.L.).

providing especially “good” goods or ordinary goods to especially worthy people, or it will prove too much and cover for-profit providers of the same goods. And, even if this problem is surmountable, the problem of subsidies through the tax system would remain. These perennial problems, “worthiness” and “fit,” have shaped the next round of exemption theory, in which theorists have looked to the meta-benefits charities provide, either uniquely or especially well, as the policy basis for their favorable tax status.

Predictably, the synthetic theories are even more arcane than their predecessors; they must both destroy what came before and rebuild something serviceable from the wreckage. That said, the basic structure of all these synthetic theories is essentially simple. First, the synthetic theories reject the premise of both the technical definition theory and the traditional subsidy theory. The exemption and deduction are not mere technical refinements of charity and donor income, but neither are they simply subsidies of the goods and services that charities provide.

Having thrown out the bathwater, the synthetic theories then try to rescue the baby, salvaging an insight from each rejected theory. Although the exemption and deduction are in fact subsidies, what they subsidize is not quite what traditional subsidy theory maintained. The traditional theory focused on what synthetic theories identify as “primary benefits” - ordinary goods to the needy, especially “good” goods for anyone else. What the exemption and the deduction actually subsidize, according

to the synthetic theories, are “meta-benefits,” the normatively appealing ways that charities provide those primary benefits. Exemption and deduction are means of promoting not what charities do, but how they do it. This third approach shifts focus from the primary benefits like health care, education, and relief work to “meta-benefits” like efficiency, innovation, diversity and other socially desirable modes or aspects of charitable provision of goods or services.

Typical of their time, theorists of this third, synthetic school saw these meta-benefits first through the lens of neo-classical economic analysis, then through criticism of that mode of analysis. For the economic analyst, Henry Hansmann, the defining benefit of charity is the efficient satisfaction of the demands of their patrons, those who donate to charities or purchase from them, under conditions when efficient provision by for-profit firms would predictably fail. Drawing from political and moral theory, Hansmann’s critics saw his lumping together of those who give to charity and those who purchase from them as peculiar, if not perverse. In their view, the essence of charity lies in the very fact that Hansmann’s theory obscures: the fact that donors give, through charities, to others.

1. Hansmann’s Capital Formation Theory

Hansmann justifies the charitable tax exemption as an appropriate means to encourage their accumulation of capital. This normative rationale for the exemption rests on his descriptive account of the function of nonprofit firms in

a capitalist economy in which for-profits properly predominate. Hansmann argues that nonprofits tend to arise as the most economically efficient suppliers of goods and services when the normal for-profit provision fails for a particular set of reasons. Economic theory tells us that consumers usually know what goods and services they want to buy, that they are usually able to tell whether they got what they paid for, and that competition among for-profit suppliers usually ensures that they paid the lowest possible price.

But sometimes these conditions are not met; sometimes the market fails. Hansmann suggests that “nonprofit enterprise is a reasonable response to a particular kind of ‘market failure,’ specifically the inability to police producers by ordinary contractual devices.” His generic term for this problem is “contract failure.”³⁹ Hansmann identifies three basic forms of contract failure that nonprofit firms help their patrons avoid: information asymmetries in the market for complex goods and services, information asymmetries in the provision of ordinary goods to distant third parties, and positive externalities associated with certain goods and services like public broadcasting.⁴⁰

³⁹ See Henry B. Hansmann, *The Role of Nonprofit Enterprise*, 89 YALE L.J. 835, 845 (1980) [hereinafter *Nonprofit Enterprise*].

⁴⁰ See *id.* at 845-72. Hansmann does not treat these three kinds of contract failure as exhaustive; indeed, he identifies two others--voluntary price discrimination and implicit loans. See *id.* at 854-62. He uses the former to explain patrons' contributions to performing arts organizations and the latter to explain alumni donations to colleges and

Nonprofit providers help their patrons avoid these special market failures, because all nonprofits operate, by definition, under the nondistribution constraint: nonprofit firms cannot pay out net profits to a class of owners or controllers. Thus, in each of the three forms of contract failure he identifies, Hansmann maintains that the nonprofit firm, with the nondistribution constraint as its essential characteristic, gives consumers the assurance that their difficulty in evaluating output will not be exploited to enhance distributable profits.

It is tempting to draw from this descriptive analysis the normative conclusion that nonprofits should be encouraged by the indirect subsidy of a tax exemption to develop in industries that exhibit contract failure. Hansmann cautions, however, that this explanation oversimplifies: “Why can consumers not be trusted to select nonprofit rather than proprietary producers on their own in those situations in which nonprofits are to be expected to offer more reliable service?”⁴¹

Hansmann identifies a less immediately apparent, but ultimately more satisfactory, reason for exempting the net revenues of such nonprofits from income taxation. This encouragement is needed because nonprofits, by definition forbidden to distribute net profits, are barred from a primary source of capital for expansion: equity investment.

universities.

⁴¹ Exempting Nonprofit Organizations, *supra* note 24, at 70-71 (footnote omitted); see also Charitable Status, *supra* note 27, at 374.

Moreover, they are likely to be unable to expand to an optimal size using either borrowed capital, donated capital, or retained earnings.⁴² The exemption of their income from taxation is an appropriate and effective form of encouragement, since it helps offset this disadvantage in access to capital by increasing nonprofits' ability to retain net earnings for expansion.⁴³ If this is how nonprofits will use their enhanced net revenues,⁴⁴ and if we accept the implicit normative premise that, other things being equal, efficient allocation of resources is to be encouraged, then

⁴² See Exempting Nonprofit Organizations, *supra* note 24, at 72-74. Empirical research on the effect of capital constraints on the responsiveness of nonprofits to changes in demand is inconclusive. See Henry B. Hansmann, *Economic Theories of Nonprofit Organizations*, in THE NONPROFIT SECTOR 27, 38-39 (Walter W. Powell ed. 1987) [hereinafter *Economic Theories*]; Richard Steinberg, *Nonprofit Organizations and the Market*, in THE NONPROFIT SECTOR 118, 133-34 (Walter W. Powell ed. 1987).

⁴³ See Exempting Nonprofit Organizations, *supra* note 24, at 72-75; *cf.* Utah County v. Intermountain Health Care, Inc., 709 P.2d 265 (Utah 1985). In Utah County, in response to the dissent's argument that denial of property tax exemption to two components of nonprofit hospital network would result in higher costs to patients, the majority argued that "[t]he far more logical assumption is that growth of the IHC system would possibly be slowed." *Id.* at 276.

⁴⁴ Hansmann himself has provided empirical evidence in support of his capital formation hypothesis. See Henry B. Hansmann, *The Effect of Tax Exemption and Other Factors on the Market Share of Nonprofit Versus For-Profit Firms*, 40 NAT'L TAX J. 71 (1987) [hereinafter *Effect of Tax Exemption*].

this is an entirely appropriate conclusion.⁴⁵

Hansmann's theory has several obvious strengths. Most obviously, it puts some starch into the claim of traditional subsidy theory that nonprofits sometimes are more efficient than alternative, for-profit suppliers. He has, accordingly, identified a meta-benefit that warrants subsidizing nonprofits with a tax exemption while explaining the denial of that benefit to for-profits in the same industry: for-profits do not labor under the same capital constraints. Furthermore, owing to the very market failures that give rise to nonprofits in some industries, for-profits might be able to siphon off the subsidy in the form of higher profits rather than pass it on to consumers in the form of higher output or lower prices.

Hansmann's rationale for the exemption also gives a plausible link between the amount of the exemption's indirect subsidy and the subsidized charity's need for capital. Where demand for a good provided by a nonprofit is rising, its retained earnings will also rise,⁴⁶ and thus a subsidy tied to net revenues is scaled to the need for expansion. Another appeal of Hansmann's theory is its implications for comparing, not just identifying, charities. It incorporates the basic metric of economic efficiency; that

⁴⁵ Although Hansmann only applied his capital formation theory to the exemption, parallel considerations weigh in favor of the deduction as well. Just as the exemption helps under-capitalized charities retain earnings, so the deduction should help raise capital by subsidizing donations.

⁴⁶ See *Exempting Nonprofit Organizations*, *supra* note 24, at 82-84.

metric is widely, some would say universally, applicable, not limited to a single sector, much less industry. And that metric is intrinsically quantitative and calibrated in a common currency. As a measure of consumer satisfaction, economic efficiency counts only the dollars that consumers actually have and are willing to spend.

Finally, since both parts of Hansmann's theory, the descriptive and the normative, focus on correcting market failures, his theory maps nicely onto the standard model of philanthropy's account of the state's regulatory function. His three forms of contract failure, as we have seen, are special cases of standard market failures, information asymmetries and externalities. If the state wants to encourage economically efficient charity, it can include, among its many other market-correcting mechanisms, the exemption of charitable income as a sensible form of assisting their accumulation of capital. This, in turn, will bring charitable firms "on-line" faster to provide the goods and services of which the non-distribution constraint makes them the most economically efficient suppliers.

For all its elegance, however, Hansmann's theory has three disquieting features.⁴⁷ First, it suggests a radical narrowing of the present exemption. Hansmann concludes that the exemption should apply to only those nonprofits

⁴⁷ Although Hansmann and others originally directed these objections to the exemption, they apply with equal force to the deduction. For both brevity and fidelity to the original discussion, the following text speaks only in terms of the exemption.

that arise in response to the kind of market failure he has identified. Hansmann concedes that “[i]f nonprofit firms could be demonstrated to have important efficiency advantages over for-profit firms under identifiable conditions other than contract failure, similar reasoning could justify granting tax exemption to nonprofit firms in those circumstances as well.”⁴⁸ Despite his concession that there may be other forms of “efficient” nonprofits than those he has recognized, the tenor of his writings suggests that he believes the canon is essentially closed.

He himself is willing to concede that some traditionally exempt charities that do not fit his efficiency criteria—in particular, those providing education, hospital care, nursing care, and day care—should continue to be exempt because, in “a significant fraction of these industries ... a substantial subset of consumers feels more comfortable patronizing a nonprofit.”⁴⁹ Hansmann would, however, continue the exemption only “until we have better data suggesting that these consumers are mistaken.”⁵⁰ By implying that a defense of the charitable exemption can

⁴⁸ Exempting Nonprofit Organizations, *supra* note 24, at 87 n.92.

⁴⁹ *Id.* at 89.

⁵⁰ *Id.* More recently, Hansmann seems less inclined to give such nonprofits the benefit of the doubt. See Exempting Nonprofit Organizations, *supra* note 24, at 634; see also Henry B. Hansmann, *The Evolving Law of Nonprofit Organizations: Do Current Trends Make Good Policy?*, 39 CASE W. RES. L. REV. 807, 822-24 (1988-89) (urging continued contraction of the scope of nonprofit tax exemption) [hereinafter *Evolving Law*].

only be made in terms of economic efficiency, Hansmann ignores the possibility that other asserted meta-benefits of charity might justify the exemption subsidy on other, perhaps broader, grounds.

Second, by Hansmann's own admission, the need for state assistance to charity capital formation, through tax exemption or other means, is not very great. Here the robustness of his descriptive theory of charities as an economically efficient consumer response to contract failure undermines its normative counterpart, tax exemption as a response to charities' limited access to capital. His descriptive models suggest that, even in the absence of tax exemption, nonprofit suppliers would probably come to dominate industries in which they are the most efficient suppliers.⁵¹ At most, the exemption's indirect subsidy accelerates an optimal outcome that will occur eventually, though more slowly, without state intervention. And offsetting even this advantage is the fact that the exemption will allow modestly inefficient nonprofit firms to compete with more efficient for-profits, perhaps successfully enough to dominate entire industries.⁵²

Furthermore, even as the need for the exemption subsidy is slight under Hansmann's analysis, so the link between tax exemption as a means and capital formation as

⁵¹ See *Exempting Nonprofit Organizations*, *supra* note 24, at 83-84.

⁵² See *id.* at 83. See also *Charitable Status*, *supra* note 27, at 388 (criticizing Hansmann's failure to show why tax subsidy is better than grants or tax-exempt bond financing).

an end is loose at several points. First, nonprofit managers may choose to increase present production rather than expand.⁵³ If they do, the subsidy will not work as intended.⁵⁴ More fundamentally, the tax exemption is not nicely calibrated to subsidize only those nonprofits that are in fact undercapitalized.⁵⁵ Hansmann admits that, for the tax exemption to serve as an effective capital formation subsidy, it should apply only to organizations that meet two criteria: (1) they are more efficient producers than alternative for-profit firms, and (2) they are undercapitalized.⁵⁶ The first criterion is met by limiting the exemption to organizations in industries beset by contract failure. However, the second criterion is, by Hansmann's own admission, not feasible to measure.⁵⁷ Hansmann, to his credit, candidly concedes that tax exemption is, at best, "an extremely crude mechanism for dealing with the problems

⁵³ Hansmann recognizes this possibility. *See* Exempting Nonprofit Organizations, *supra* note 24, at 80-81. And there's still a gloomier prospect: waste. Nonprofit managers, who are not subject to scrutiny by equity owners, may exert themselves less than their counterparts in for-profit firms to minimize costs. *See* Evelyn Brody, *Agents Without Principals: The Economic Convergence of the Nonprofit and For-Profit Organizational Forms*, 40 N.Y.L. SCH. L. REV. 457 (1996).

⁵⁴ But note that the exemption will make expansion relatively more attractive if we assume that in a world without the exemption, expenditures for increased current production go untaxed. *See* Exempting Nonprofit Organizations, *supra* note 24, at 82.

⁵⁵ *See* Dale, *supra* note 36, at 8.

⁵⁶ *See* Exempting Nonprofit Organizations, *supra* note 24, at 86.

⁵⁷ *See id.*

of capital formation in the nonprofit sector.”⁵⁸

The most disquieting aspect of Hansmann’s theory lies deeper in his descriptive account of the role of nonprofits. To see more concretely what Hansmann’s theory omits, we need to examine his conflation of donations and purchases, a revealing peculiarity in the way he explains nonprofits as a solution to contract failure. This peculiarity is most apparent in Hansmann’s discussion of relief organizations like CARE, his prototypical case of contract failure.

Somewhat counter-intuitively, Hansmann speaks of those who finance CARE’s overseas relief operations as “customers,” rather than, as ordinary usage would suggest, “contributors” or “donors.” Hansmann’s choice of terms is not accidental. As he says in discussing another relief organization, the Red Cross:

[T]he contributor is in effect buying disaster relief. And the Red Cross is, in a sense, in the business of producing and selling that disaster relief. The transaction differs from an ordinary sale of goods or services, in essence, only in that the individual who purchases the goods and services involved is different from the individuals to whom they are delivered.⁵⁹

⁵⁸ Exempting Nonprofit Organizations, *supra* note 24, at 92.

⁵⁹ Exempting Nonprofit Organizations, *supra* note 24, at 61 (footnote omitted); *see also* Nonprofit Enterprise, *supra* note 39, at 872-73.

It is both accurate and instructive to point out a structural similarity between contributions and purchases, but it is something else to dismiss the significance of who gets the goods. A physicist can, with equal accuracy, describe all music as a series of vibrations; a philistine can reduce violin music to a horse's tail on a sheep's gut. In both descriptions, however, something critical is missing, at least to the aficionado.

So, too, in the cases of CARE and the Red Cross. Economic efficiency gives us a very precise mechanism for measuring how good a particular charity is, but the measure of that good reminds us of how very odd that good itself is: giving society's "haves" more of what they want, precisely because it is what they want. A theory that literally denies the relevance of a starving person's need for bread and instead focuses on how much others are willing and able to pay to supply the bread is, at very best, a deeply counterintuitive account of charity (to say nothing of justice). And yet that is, after all, quite precisely what the meta-benefit of economic efficiency comes down to.

What is missing in Hansmann's analysis of gifts to relief organizations like CARE is what appears, before we examine these gifts through the lens of economic analysis, to be their most salient feature: the kind of selfless regard for others that we associate with the core of charity. Moreover, the case of CARE offers the prospect of a proxy, or a metric, for what may be the quintessence of charity: one person's conferring of a benefit on another without the

expectation of a material reward. Two other meta-benefit theories have tried to give these insights greater clarity and rigor. Both these theories attempt to re-focus the rationale for the charitable exemption on the disinterested generosity of their donors.

2. The Meta-Benefits of Giving: Putting Selflessness Back into the Analysis

Hall and Colombo offer an argument within the framework of economic analysis for subsidizing donative organizations as economically efficient; I offer an argument outside economic analysis for exempting a wider range of nonprofit organizations as the institutional embodiments of various forms of altruism. Although both theories, following Hansmann, focus on the exemption, both, like Hansmann's theory, could be extended to the deduction.⁶⁰ Since Hall and Colombo answer Hansmann in his own economic terms, let us consider their theory first.

a. Hall and Colombo's Donativity

⁶⁰ For an extrapolation of my exemption theory to the deduction, see FRANCES R. HILL AND BARBARA L. KIRSCHTEN, FEDERAL AND STATE TAXATION OF EXEMPT ORGANIZATIONS 15-27 (1994) (specifically Chapter 15, Theories of the Special Tax Treatment of Nonprofit Organizations). Mark Gergen has made the economic case for contributions that parallels Hall and Colombo's exemption theory. Mark Gergen, *The Case for a Charitable Contributions Deduction*, 74 VA. L. REV. 1393 (1988). Gergen, like Hall and Colombo, points out that truly disinterested, public-spirited gifts are subject to free-rider problems; a subsidy of such gifts through the donation deduction should help ensure a more nearly efficient supply of the goods and services for which they are given.

Theory

To see how Hall and Colombo justify their donative theory in economic terms, we must return to Hansmann's argument that the greater efficiency of nonprofits in some industries is not itself a sufficient reason to warrant treating them more favorably under tax laws than their for-profit counterparts. His reason for requiring something more is summed up in the rhetorical question, "Why can consumers not be trusted to select nonprofit rather than proprietary producers on their own in those situations in which nonprofits are to be expected to offer more reliable service?"⁶¹ A critical assumption here is that, with the problems of contract failure redressed by nonprofits through the nondistribution constraint, their customers will purchase the amount of goods and services from them that maximizes their marginal utility, and hence a socially optimal level of production will occur. Patrons quite literally get what they pay for and thus can be depended upon to buy as much as, and no more than, they want.

Hall and Colombo nicely isolate a flaw in this reasoning: Although it may be true of commercial nonprofits, those financed by the sale of goods and services to those who consume them, it is probably not true of donative nonprofits, those through which patrons are buying goods or services to be consumed by strangers or by the public at large. Donative nonprofits may not produce an

⁶¹ Exempting Nonprofit Organizations, *supra* note 24, at 70; *see also* Charitable Status, *supra* note 27, at 374.

optimal level of output because wealth redistribution, an integral component of their output, is in some respects a public good. To the extent that donors' utility is tied to the receipt of benefits by others, rather than the act of giving itself, donors will be tempted to free-ride on the gifts of other donors. Accordingly, what the donors are really interested in buying—the provision of goods or services free or below cost to others—will probably be chronically undersupplied. In the case of donative nonprofits, Hall and Colombo thus conclude that subsidization is economically justified.⁶²

Hall and Colombo's analysis produces a justification for the tax exemption that is significantly narrower than Hansmann's with respect to both donative and commercial nonprofits. This is somewhat surprising with respect to donative nonprofits, since Hall and Colombo's theory covers all donative nonprofits, not just those that are undercapitalized. This greater theoretical breadth is not likely to make their theory broader in application, however, for three reasons. First, Hansmann argues that most donatively financed organizations are likely to be undercapitalized.⁶³ Second, Hansmann concedes that, in practice, undercapitalization could not be made an administratively feasible criterion for exemption.⁶⁴ Third, in describing the implementation of their theory,

⁶² See Donative Theory, *supra* note 27, at 1389-98.

⁶³ Exempting Nonprofit Organizations, *supra* note 24, at 72.

⁶⁴ See *id.* at 75.

Hall and Colombo insist that even donative organizations, in order to continue to qualify for the exemption, would have to receive an average of one-third of their annual support from donations.⁶⁵ This condition would bar the exemption of most private foundations, both operating and grant-making, and perhaps many heavily endowed and fee-supported public charities like museums and schools.

With respect to commercial nonprofits, the donativity theory calls for an even greater narrowing, compared both to Hansmann and to existing law. Hansmann would extend the exemption to a potentially large class of commercial nonprofits that supply complex goods and services to a substantial number of customers who feel more comfortable buying from nonprofits on account of information asymmetries—the difficulties consumers have directly assessing product quality themselves. Hall and Colombo, on the other hand, see no evidence of donations in the case of such commercial nonprofits. They thus find no room for them in an exemption designed to overcome the free-rider problems associated with donative financing.⁶⁶

Hall and Colombo offer an elaborate economic explanation of why the charitable exemption fits their proffered basis for exemption: the organization's support

⁶⁵ See *id.* at 104.

⁶⁶ See James Bennett & Gabriel Rudney, *A Commerciality Test to Resolve the Commercial Nonprofit Issue*, 36 TAX NOTES 1095, 1097-98 (1987) (proposing an analogous exclusion of commercial organizations).

by donations. I cannot even begin to do justice here, either to their own argument or to my reservations about it. Even if their theory is right on this point, its implementation produces a paradox. The more donative support an organization receives, and thus the more deserving it is of subsidy in terms of the likely undersupply of the good it produces, the greater will be its ratio of donative to other income and the less helpful the subsidy will be. Gifts are not ordinarily included in income anyway, and even if they were, they could be offset by an operating expense deduction if they were disbursed.⁶⁷

b. Atkinson's Altruism Theory

My own rationale for the exemption shares Hall and Colombo's focus on donations but differs in its scope and ultimate rationale. To begin with the difference in scope, I, unlike Hall and Colombo, find a donative element in commercial nonprofits, even in commercial nonprofits that supply garden variety goods,⁶⁸ not just those goods that Hansmann identifies as complex and difficult for the consumer to evaluate. To find an element of donativity (or, as I prefer to call it, altruism) here, we must look on the supply side. How does capital get into such firms in the first place? If pooled by buyers, the resulting organization is a mutual benefit nonprofit or a cooperative, an

⁶⁷ I owe the identification of this paradox to Hall and Colombo themselves. See *Donative Theory*, *supra* note 27, at 1445, 1453 n.224; see also *Charitable Status*, *supra* note 27, at 403 n.342.

⁶⁸ My favorite example, *Presbyterian & Reformed Publ'g Co. v. Commission*, 743 F.2d 148 (3d Cir. 1984), involves books.

organization in which the consumer-members are primarily interested in helping themselves.

But, if the capital is provided by non-purchasers, that provision itself is altruistic. Whenever an organization with the potential to return profit to its founders is set up on a nonprofit basis, the founders have necessarily forgone that potential profit. The net revenues that otherwise would have been distributable to its founders are now committed to the purposes for which the organization was created. Moreover, as long as the organization continues to abide by the non-distribution constraint, its potential profits are available for subsidizing the purchases of its patrons. The founders' initial contribution of their potential earnings thus has an ongoing aspect; the organization embodies their altruism. As long as it remains nonprofit, this element of altruism remains, even if all other factors of production must be purchased at market prices. This makes for an exemption that is extremely, perhaps shockingly, broad; broader than Hansmann's and Hall and Colombo's ideal exemption and the exemption in present law.

How can such breadth be defended? Here we reach the second difference between myself on the one hand and Hall and Colombo on the other, the divergent grounds on which we would favor altruistic organizations. Hall and Colombo ground subsidy of donativity on the meta-benefit of its economic efficiency. In their view, it combats free-rider problems associated with donations, thus moving donations up to more economically efficient levels. What the exemption does, in my theory, is grant advantageous

tax status to organizations that exhibit altruism either as donative nonprofits or as the kind of altruistic commercial nonprofits that I have identified. My rationale is that altruistic supply of a good or service—any good or service—is a meta-benefit worthy of consideration for tax preference. The meta-benefit of charity, in my view, is not that they meet patron demands efficiently, but that they supply the wants or needs of others, including the public, altruistically.

c. The Gift Theories' Paradoxical Embrace of Hansmann's Focus on Donors Instead of Donees

Hall and Colombo and I balked at Hansmann's treatment, in both his descriptive and normative theory of charity, of donations as purchases. True, donors are paying for goods and services, but sometimes they are buying those goods and services for others. In reaction to Hansmann, we emphasized this difference, the inherently donative or altruistic aspect of charitable gifts. In so doing, however, I am now afraid we followed Hansmann's lead at least as much as we departed from it. We missed a fundamental, and I now think unfortunate, similarity of our theories and his: all our theories focus on donors, not donees. Hall and Colombo and I failed to see that, even as we insisted on distinguishing gifts from purchases, we left the focus on the giver, not the receiver, and not the gift. In making the donor's lack of a material quid pro quo the essence of charitable giving, we put the helper ahead of the helped.

This is at least a little odd. Logically, the donee's need must come before the donor's satisfaction of that need. And normatively, the fact that the gift actually satisfies a real need, not the fact that the giver receives no material quid pro quo, must be the essence of the gift's merit. Having faulted economists for being indifferent as to whether bread goes to hungry birds or starving children, we committed at least an equal normative oversight: we treated donations to the charities that feed birds as no different from donations to charities that feed children.

In their agnosticism about the merits of the objects of the gifts, the altruism and donativity theories thus take us back, ironically, to the perspective of the very economic theory that these theories were supposed to supplant. Although these theories focus on what givers give to others, not the satisfaction the gift gives the givers themselves, these theories nonetheless ignore what receivers get. It is at least a little ironic for theories that focus on altruism, selfless consideration for others, to ignore how much benefit these others actually get.⁶⁹

Looking back, I think the reason for our oversight was that focusing on the donor's gift, rather than the donee's need, gave us a readily quantifiable metric. Donors

⁶⁹ As Teresa Odendahl's work revealed, at least to me, when we actually do focus on donors not as an abstraction, "the supply side," but as individuals and as a social class, what we see may not be altogether lovely. See TERESA ODENDAHL, *CHARITY BEGINS AT HOME: GENEROSITY AND SELF-INTEREST AMONG THE PHILANTHROPIC ELITE* (1990).

give dollars, or property with readily obtainable market valuation; if the gift is not in cash or otherwise readily appraisable, there is no question of a deduction for the donor and, on the other side, no question of income for the organization. But need knows no such easy metric. A loaf of bread (more likely, a liter of glucose) can save a child's life, and the price of bread (and glucose, too) is easy to state in dollars and cents. What the child's life is worth in cold, hard cash is harder (and colder) to say.

We missed, to take a less pointed example, the wisdom of the proverb we have cited before: Give children a fish, and you've fed them for a day; teach children to fish, and you've fed them for a lifetime. Of course, it would be better still—perhaps twice as good—to teach two children rather than one to fish, even as it would be to give two children a loaf of bread each. But it is much harder to quantify the difference between any given teaching and the alternative of feeding. It would doubtlessly be harder still to quantify the difference between teaching a child to fish and teaching a child to teach another child to fish.

On the other hand, it is important not to sell Hansmann's economic theory, and Hall and Colombo's refinement of that theory, short. At this most critical point, we need to remember something distinctive about economic theory generally, which will allow us to see Hansmann's theory, and Hall and Colombo's corrective, as vitally different from both my own meta-benefit theory and the technical definition theory. Economics specifies a single value, consumer satisfaction, and measures that

value in terms of consumer willingness and ability to pay. We have focused primarily on the limitations of that approach, its indifference to two of the state's legitimate functions, redistributing wealth and promoting excellence.⁷⁰ But this weakness is also, from another perspective, a great strength: it radically simplifies the analysis; the point of abstracting away considerations of need and excellence, like putting blinders on a draft horse, is to focus attention on an admittedly narrow, but nonetheless necessary, task.

In that sense, Hansmann's and Hall and Colombo's theories nicely fit the state's regulatory, wealth-maximizing function.⁷¹ Hansmann has given us a very precise theory for the state's regulatory function as applied to charity. By treating gifts as purchases, a counter-intuitive perspective of real cleverness, and working out the implications, he has given us an amazingly clear blueprint of charity as a part of our society's economic sector, and of how the state, as regulator, should treat it. His contract failure descriptive account and his capital formation normative account is just what we would need if we were to concern ourselves solely with the state's regulatory function, maximizing economic efficiency. As a refinement of that theory, Hall and Colombo's donativity theory fits nicely here as well.

Again, this theory is, in its very essence,

⁷⁰ *See id.*

⁷¹ Which necessarily incorporates its Ricardian, property-protecting function. *See Atkinson, Re-Focusing Philanthropy, supra* note 8.

quantitative. At least in principle, we can measure how much more economically efficient charities are than for-profits and how much their restricted access to capital inhibits their expansion to an appropriate market share, and then calibrate the exemption accordingly. Similarly we can (again, in principle) calculate how much the free-rider phenomenon dampens charitable donations and adjust the deduction to correct for the problem. In both cases, in determining the proper level of complexity, we could take the problem of diminishing returns into account: beyond some point, complexity in the regulatory system will cost more than it increases the efficiency of outcomes. Theories based on economic efficiency could thus give very real and quantifiable direction to the structuring of both the exemption and the deduction.

At another level of analysis, that of individuals operating within the system,⁷² the guidance from economic analysis is a bit less helpful. It is hard to imagine that many donors to charity, for example, will want to direct their gifts so as to maximize the economic efficiency of the economy as a whole. More likely, individual donors will want to contribute where they can, for want of a better phrase, do the most good. On that point, the criterion of economic efficiency is no help at all; it is designed to measure to what extent those who are willing and able to pay get what they

⁷² See Atkinson, *Re-Focusing Philanthropy*, *supra* note 8. See *supra* Part I.A. (drawing this distinction, following the classical distinction between ethics and politics).

want, not to tell them what to want. This absence of guidance to individual donors is simply the converse of a cardinal virtue of economic theory, indifference as to kinds of satisfaction. What makes efficiency appealing is its very capacity to avoid qualitative measures of consumers' preferences.

Seen in this light, what troubles us about economic theories of charity is that they ignore two other legitimate state functions, redistributing wealth and promoting the production and consumption of superior products.⁷³ By emphasizing the goodness of giving as such, not merely as the source of yet another market failure, my altruism theory was, in effect, trying to move beyond the state's regulatory function, trying not to reduce the virtue of charity to a species of economic efficiency. By treating altruism as an independent virtue, I was (quite unknowingly) offering an aretist theory of philanthropy, a theory that focuses on its promotion of an identifiable social and individual virtue.

But, by making altruism the sole virtue of charity, I offered a very peculiar aretism indeed. By extending philanthropy to cover all genuinely nonprofit activities, thus making the donor's choice of philanthropic objects a

⁷³ RICHARD A. MUSGRAVE & PEGGY B. MUSGRAVE, PUBLIC FINANCE IN THEORY AND PRACTICE 83 (3d ed. 1980) (recognizing "that the quality of wants may differ" because "[s]ome are concerned with the more noble and others with the baser aspects of life"); *id.* at 320 ("In this case [that of taxing 'demerit' goods and subsidizing 'merit' goods], the usual efficiency argument based on free consumer choice is inapplicable and social preferences is substituted for private choice.").

matter of normative indifference, I stumbled into exactly the liberal democratic counterpart of Hansmann's and Hall and Colombo's capitalist market theories of philanthropy. My altruism theory, I now regret to realize, is the perfect picture, normative and descriptive, of philanthropy in a society where everyone's opinion about the public good, like everyone's dollar in the marketplace, is of absolutely equal value. My aretism is perfectly democratic: whatever cause any giver cares to give to is good, by virtue of the very fact that it is a gift to a cause someone cares about.

In effect, my theory gives givers exactly the recognition, in ethics and politics, that givers want for their gifts, and one thing more: a tax subsidy. As we have seen, that was a happy accident, not a neat intuition.⁷⁴ It gives us the basis for making a virtue of what seems to be a necessity of defining philanthropy in a liberal democracy: omitting any standard by which to judge some visions of the public good to be better than others. This negative virtue, failure to make comparisons among particular primary goods, lies at the root of all the philanthropic meta-benefits that the traditional subsidy theory always asserted but never elaborated, especially pluralism, diversity, efficiency and innovation. What looks, from any other perspective, like a fundamental weakness of the traditional subsidy theory thus becomes, from the perspective of liberal democracy, its defining strength. Part II unpacks that

⁷⁴ But, as I shall argue later still, this is a terribly bad idea. *See infra* Part III.

paradox.

III. THE TRADITIONAL SUBSIDY THEORY RECONSIDERED: FAVORING TOCQUEVILLEAN PHILANTHROPY

The traditional subsidy theory, as we have seen, presents three basic problems: no substantive definition of charity, no convincing justification of subsidizing charity through the tax system, and no compelling reconciliation of the tax system's subsidizing religion with the Constitution's ban on establishing religion. On closer inspection, however, we can see that the traditional subsidy theory, reexamined through the lens of two schools of criticism we have identified, the technical definition theory and the meta-benefits theories, proves surprisingly sensible. On the one hand, the special tax treatment may best be seen, as the technical definition theory suggests, as something other than a subsidy, although not, at the same time, as a purely technical artifact.⁷⁵ On the other hand, the very absence of standards in the traditional theory's definition of charity may prove to be a virtue, if only a virtue born of necessity.⁷⁶ As previously noted, it is a virtue

⁷⁵ See Federal Tax Treatment, *supra* note 6, at 275 ("Whether exemption and deductibility are subsidies or whether they are functions of an accurately defined tax base, Congress surely must specify which entities are taxed and which are not.").

⁷⁶ See *id.* at 279 ("Yet it is plausible to contend that what some perceive as the evil of privatization is the necessary corollary of a decision to leave some judgments about what constitutes the public interest to a

functionally related to our liberal democratic political system.⁷⁷ Given that our fiscal system rests on an income tax, that our political system is a liberal democracy, and that our economy is a capitalist market, we may have arrived at something very like the ideal tax treatment of charity – for us.

This neo-traditional theory will have important quantitative implications as well, paradoxical though they may at first appear. It may not be possible to measure the relative benefits of philanthropy at the highest level of analysis, that of political theory. But it may be quite possible at the level of ethical theory, which analyzes individual citizens' choice about which causes to support and how much. That may be, not an accident or an anomaly, but a defensible fiscal and political arrangement, as consistent with our liberal democratic political system as the income tax exemptions and deductions are with our income-based fiscal system. Seen in that light, the current system has much to recommend it, as a complement to both

robust, independent, and pluralistic charitable sector instead of committing all such determinations to the majoritarian processes of government.”).

⁷⁷ See *id.* at 275 (“A system that provides for diverse decentralized decision making about which visions of public benefit merit support is well suited to a heterogeneous society, where many citizens prefer a supply of public goods – like culture, health, welfare, and protection of civil rights and the environment – that exceeds what majoritarian political processes will provide.”) (citing BURTON WEISBROD, *THE NONPROFIT ECONOMY*).

our tax system and our political system. To see how we reach this admittedly peculiar conclusion, let us look first at philanthropy's position in our tax system, then more broadly at the place of both philanthropy and tax in our political system.

A. THE FAVORS' FORM: TAX BASE EXCLUSION, NOT INDIRECT SUBSIDY

As we have seen, the appropriateness of subsidizing charity through the income tax system is widely criticized. It is not well linked with charity's particular virtues (whatever they are), and tax subsidies as a general matter are thought to be fiscally inefficient. I have suggested earlier—"tentatively, with trepidation"—that the fit issue may, in important respects, be an illusion.⁷⁸ Now I want to suggest, much more strongly, that it is something of an advantage, and in any event not an embarrassment. The indirectness of the subsidy through tax exemption is not, as I formerly feared, primarily a matter of political expediency, the result of inability to secure more direct subsidies. It may better be seen as partly a matter of political preference and partly an artifact of the present tax system.

Let us, consider, first, the favorable tax treatment of philanthropy as an artifact of our tax system. Recall the

⁷⁸ Rob Atkinson, *Theories of the Special Tax Treatment of Nonprofit Organizations*, in Frances R. Hill and Barbara L. Kirschten, *FEDERAL AND STATE TAXATION OF EXEMPT ORGANIZATIONS* CHAPTER 15, 15-27 (Frances R. Hill & Barbara L. Kirschten, eds., 1994).

central point of the fit question: What does the level of an organization's income have to do with the degree to which it should be subsidized? This question can usefully be turned around: What relation does the level of an organization's (or an individual's) income have to do with the extent to which it (or he or she) should bear the costs of government? I suggest we turn the question around this way for two related reasons. First, it points to an implicit assumption in the question about fit, namely, that there is something natural, inevitable, or correct about financing government operations with an income tax geared to net revenues. If the history of this country up until this century and the current tax systems of other liberal democracies may be admitted into evidence, there is not. Turning the question around thus reveals that the question of fit cannot be avoided by eliminating the charitable exemption. It makes as much sense to seek the fitness of a tax on income as it does to seek the fitness of a subsidy based on income. It has never been clear that, in the broader context, the fitness question has been compellingly answered.

A basic question of a general revenue tax is how to allocate its burden among taxpayers fairly.⁷⁹ Benefits received from expenditure of general revenue levies are

⁷⁹ See RICHARD A. MUSGRAVE & PEGGY B. MUSGRAVE, *PUBLIC FINANCE IN THEORY AND PRACTICE* 225, 227 (4th ed. 1989) [hereinafter *Musgrave & Musgrave*]; WILLIAM A. KLEIN, JOSEPH BANKMAN, DANIEL N. SHAVIRO & KIRK J. STARK, *FEDERAL INCOME TAXATION* (7th ed. 1987) [hereinafter *Klein*].

notoriously difficult to measure,⁸⁰ leaving ability to pay as the most widely accepted criterion.⁸¹ Choosing ability to pay as the base raises the next question, the best method of measuring that capacity. Here there are three basic options: income, consumption, and wealth.⁸² Income, of course, is the mainstay of the federal tax system, but the case for choosing income has a long line of careful and cogent critics. Moreover, even those who accept income as the better measure of ability to pay generally admit that income is hardly the perfect measure, particularly when debate moves from theory to implementation.⁸³ Here is the first light that general tax theory sheds on the fit issue of charitable tax exemption: those who seek a particularly close fit between the purpose of the exemption and its beneficiaries' net income without showing any such fit between income and ability to pay, the very target of the

⁸⁰ Musgrave & Musgrave, *supra* note 79, at 228-32; Klein, *supra* note 79, at 17; RICHARD B. GOODE, *THE INDIVIDUAL INCOME TAX* 17-19 (rev. ed. 1976) [hereinafter GOODE].

⁸¹ Klein, *supra* note 79, at 17; GOODE, *supra* note 80, at 17-19; Musgrave & Musgrave, *supra* note 79, at 232.

⁸² Harvey E. Brazer, *The Income Tax in the Federal Revenue System*, in *BROAD-BASED TAXES: NEW OPTIONS AND SOURCES* 3, 4 (Richard A. Musgrave ed., 1973) [hereinafter Brazer]; GOODE, *supra* note 80, at 12; Musgrave & Musgrave, *supra* note 79, at 238.

⁸³ For summaries of the debate over the relative merits of net wealth, income, and consumption based taxes, particularly the latter two, see Klein, *supra* note 79, at 18, 32-35; Brazer, *supra* note 82, at 4-6; GOODE, *supra* note 80, at 21-26; Musgrave & Musgrave, *supra* note 79, at 232-240.

income tax itself, are oddly holding an exception to the general rule of income taxation to a higher standard than the rule itself seems capable of meeting.

But, it might be objected, once an income-based system is chosen as a generally superior measure of ability to pay, fairness and consistency require that the base should be as inclusive as possible, to ensure that those equally able to pay share the burden equally.⁸⁴ Neither fairness nor consistency, however, makes the case for taxing charities. The income of charities can be excluded from the base of a perfectly sensible, internally consistent income tax system. The factors that make income a good tax base in general may not dictate including the particular income of nonprofit organizations in that base.

All taxes fall ultimately on individuals or households; the relevant “ability to pay” is really the ability of individuals to pay.⁸⁵ Whatever the means chosen to measure ability to pay—income, consumption, or wealth—the measure works best when applied directly to individuals and households. At that level of application, the tax cannot be shifted⁸⁶ and can best be calibrated to take into account

⁸⁴ See Musgrave & Musgrave, *supra* note 79, at 233-34.

⁸⁵ Brazer, *supra* note 81, at 3-4; Musgrave & Musgrave, *supra* note 79, at 223-24.

⁸⁵ Not everyone agrees that entities have no “ability to pay” relevant to tax purposes. See Hansmann, *Exempting Nonprofit Organizations*, *supra* note 24, at 22. But even if they do, the text argument for distinguishing nonprofit organizations applies.

⁸⁶ Klein, *supra* note 79, at 29 (noting that much of the advantage of the

factors relevant to individuals' ability to pay.⁸⁷ Conversely, taxes levied on entities are problematic under the ability-to-pay standard because their ultimate incidence is unclear.⁸⁸

Applied without qualification, of course, this line of reasoning proves more than necessary for present purposes, if not too much; it counsels in favor of eliminating income tax on all entities, not just charitable organizations. As previously discussed, however, it is possible to distinguish charities from for-profits by the way the former provide goods and services, even if those goods and services themselves are not distinguishable from those provided by for-profit firms. The identification of the secondary benefits associated with charities is crucial here, because it allows one to go behind a fundamental goal of any system based on ability to pay, or horizontal equity. Tax theorists, following widely shared notions of fairness, maintain that all those equally able to pay should pay equally.⁸⁹ This position rests, however, on the implicit assumption that all

individual income tax as a measure of ability to pay rests on the widely shared belief that its incidence cannot be shifted); GOODE, *supra* note 80, at 60 (citing usual view that direct taxes on personal income, consumption, and wealth cannot be shifted).

⁸⁷ See GOODE, *supra* note 80, at 11; Musgrave & Musgrave, *supra* note 79, at 223.

⁸⁸ Klein, *supra* note 79, at 29 ("it seems generally to be recognized by economists who have examined the problem thoughtfully that the incidence of the corporation income tax is wholly uncertain...."); Bittker & Rahdert, *supra* note 30, at 314-16.

⁸⁹ Musgrave & Musgrave, *supra* note 79, at 232; Klein, *supra* note 79, at 20.

else is equal. It assumes, in other words, that potential taxpayers are otherwise indistinguishable, or, more precisely, that in general no qualitative judgments about worthiness to pay can fairly or meaningfully be drawn among those of quantitatively equal ability to pay.⁹⁰

But that assumption may not hold in the context of charity. Charities can plausibly argue that they are qualitatively suited for exclusion from the tax base, on account of the secondary benefits that they confer. Indeed, ignoring these differences may undermine equity; treating unequals equally is no virtue. The poet Blake put the matter more pointedly: “One law for the lion and the ox is oppression.”⁹¹ From this perspective, the critical question becomes not whether net income should be the base for a subsidy, but whether the net income of charities should be included in the tax base or excluded to relieve them of the burdens of the government.

Turning the question of fit around that way also suggests that, if charities were taxed on their net income, the fit question would not be eliminated; we would encounter it again, albeit running in the opposite direction.

⁹⁰ See Klein, *supra* note 79, at 17 (discussing need for objective, as opposed to subjective, means for measuring ability to pay); Musgrave & Musgrave, *supra* note 79, at 244 (dismissing the question “whether it is desirable to define the tax base in terms of virtue” in rejecting the idea, traceable to Hobbes, that saving is morally superior to consumption).

⁹¹ WILLIAM BLAKE, *THE MARRIAGE OF HEAVEN AND HELL* (Dover ed., 1994).

But, the reader will object, coming from that direction it is the same for charities as for other taxpayers, namely, is net income a proper basis on which to allocate the burdens of government? While this is true enough, I would counter that even if that question is generally answered in the affirmative, a significant subquestion remains: Are there any potential tax-paying entities that ought to be relieved of bearing the burdens of government?

We are back, of course, to Bittker and Rahdert's tax base defining argument, but with a twist, and a twist that I hope to show is part of an upward spiral rather than a vicious circle. Hansmann's critique of Bittker and Rahdert showed that the income of charity could be taxed, as a matter of technical feasibility, but not that it should be taxed, as a matter of policy preference. If we define charity out of the tax base it is not because we have no other choice, as Bittker and Rahdert suggest, but because, I want to suggest, we have so chosen. Either way, however, the fit issue is defused. It is a useful, but dangerous, shorthand to describe the tax exemption as a subsidy. It is, if I am right, more properly understood and defended as an exclusion from the tax base.⁹²

⁹² See HOPKINS, *supra* note 28, at 13:

Congress is not "giving" such organizations any "benefits"; the exemption (or deduction) is not a "loophole," a "preference," or a "subsidy"--it certainly is not an "indirect appropriation." Rather, the various Internal Revenue Code provisions comprising the tax

Whatever you call it, of course, the exemption costs money, the revenues that would in its absence have been collected from the organizations within its scope.⁹³ It is this fact, I think, that inclines us to look for a tighter fit than we have yet found between the revenues foregone and the activities promoted.⁹⁴ It would be intellectually satisfying (not to mention politically useful) to be able to say that the charitable exemption and deduction are wonderfully well suited ways to subsidize what we think are the virtues of charity. But it need not be disastrous to concede that they are not. And this lack of a perfect fit as a matter of tax policy may be more than offset by more broad-based advantages of a charitable income tax exclusion.

But what about the deduction? For all we have said about the exemption as an artifact of tax-base definition, the deduction still seems to be an indirect subsidy of philanthropic gifts. To understand how to this seemingly suspect tax expenditure becomes a virtue, we must look past form to function.

B. THE FAVORS' FUNCTION: SUBSIDIZING

exemption system exist basically as a reflection of the affirmative policy of American government to not inhibit by taxation the beneficial activities of qualified exempt organizations acting in community and other public interests.

⁹³ See WEISBROD, *supra* note 24, at 161 (noting that “substantial revenue loss is one result” of the current deduction).

⁹⁴ See Charitable Status, *supra* note 27, at 329.

INDIVIDUALS' IDEAS ABOUT THE PUBLIC GOOD

This neo-technical, tax base-defining theory of the special tax treatment of charity, like its income-defining predecessor, inevitably presses us back to the more basic, substantive question: What is it about charity that warrants especially favorable tax treatment in the first place? In answering that question, as we have seen, the traditional theory fails rather badly, as do the various meta-benefit theories. But, from their very focus on meta-benefits—the way charities provide goods and services, not the goods and services themselves—we can find the contours of a different meta-benefit theory with a distinct (if conditional) appeal.

This new meta-benefit theory looks neither at the products charities provide, nor at anything special about the way they provide them, beyond the fact that they are provided by philanthropic sector organizations that are, by definition, forbidden to distribute net profits to any owning or controlling group. Instead, this theory focuses on the way those goods and services are chosen by those who support their provision; that way of choosing is, in a word, individually. Citizens decide for themselves what charities to give to and, more basically, what charities to found. This very individualism is the focus of Tocqueville's oft-quoted observations⁹⁵ about Americans' inclination to form

⁹⁵ See Steven Rathgeb Smith & Kirsten A. Gronberg, *Scope and Theory of Government-Nonprofit Relations*, in *THE NONPROFIT SECTOR* 229 (Walter W. Powell & Richard Steinberg ed., 2006) (noting that “[i]n the twentieth century, this Tocquevillian perspective was the basis for renewed attention by scholars and policy-makers.”).

associations for what they take to be publicly beneficial functions:

In no country in the world has the principle of association been more successfully used or applied to a greater multitude of objects than in America. Besides the permanent associations which are established by law under the names of townships, cities, and counties, a vast number of others are formed and maintained by the agency of private individuals

If a stoppage occurs in a thoroughfare and the circulation of vehicles is hindered, the neighbors immediately form themselves into a deliberative body; and this extemporaneous assembly gives rise to an executive power which remedies the inconvenience before anybody has thought of recurring to a pre-existing authority superior to that of the persons immediately concerned. If some public pleasure is concerned, an association is formed to give more splendor and regularity to the entertainment. Societies are formed to resist evils that are exclusively of a moral nature, as to diminish the vice of intemperance. In the United States associations are

established to promote the public safety, commerce, industry, morality, and religion. There is no end which the human will despairs of attaining through the combined power of individuals united into a society.⁹⁶

On this view, individual Americans acting in voluntary collaboration both define social problems and offer solutions to those problems.⁹⁷ Americans define the good not by a nationally shared sense of “goodness,” nor by the national recognition of social need, but rather by their joint action in voluntary associations. From this observation we can derive a Tocquevillean definition of charity: whatever nonprofit activity citizens say is in the public interest and into which they invest their time, money, or other resources. As a matter of both liberal principle and constitutional law, the state cannot discourage this kind of associational activity, unless the ends themselves can be made illegal.

But to say that the state cannot ban such associational activity is not to say that it should encourage

⁹⁶ De Tocqueville, 1 *Democracy in America*, Ch. 12, *supra* note 2. *See also* Alexis de Tocqueville, 2 *Democracy in America*, Ch. 5, University of Virginia Hypertexts Project, http://xroads.virginia.edu/~HYPER/DETOC/ch2_05.htm (last visited Mar. 11, 2010).

⁹⁷ *See* Smith & Gronberg, *supra* note 95, at 229 (“From a civil society perspective, the nonprofit sector is regarded as the embodiment of certain values that are crucial to democracy and good government.”).

it; to define Tocquevillean charity is not to prove that it is good. Thus the question of whether to relieve such public-spirited private initiatives from the burden of taxation, and further to relieve their donors to the extent of their donations is, necessarily, a normative question. Another critical feature of the Tocquevillean understanding of charity is that the majority's decision on that normative question is conclusive. Thus the functional definition of Tocquevillean charity—whatever nonprofit project anyone wants to undertake in what they take to be the public interest—is matched with its normative justification: a majority of citizens believe that this kind of social action, even by political minorities, is good in general, and also worthy of particular favor in the tax system. In a democracy, by the very definition of democracy, there is no other measure of the good. A majority can decide to grant this favor, or not; ours has granted it, and therefore it is good. The people in a democracy are, in principle, like God in a theocracy: their will is the law, and their law is right and good.

Our democracy, of course, has subjected itself to the liberal restraints contained in our constitution. Thus government favors, including special tax favors, cannot be applied in a way that discriminates against suspect classes or fundamental rights, nor in a way that imposes unconstitutional conditions on the receipt of those favors. Beyond that, a majority of citizens can choose to support, not only particular goods or services they themselves favor, but also those that their neighbors, even their neighbors in a

minority, favor. This is, in effect, what it means, in the context of the special tax treatment of charity, to say that it promotes the values, or meta-benefits, of “pluralism” and “diversity.”

This Tocquevillean account also helps give meaning to the traditional subsidy theorists’ claim that charities provide two other related meta-benefits, “innovation” and “efficiency.” The willingness of a majority of citizens to grant special tax advantages to their fellow citizens’ preferred nonprofit projects reflects not only respect for their fellow citizens’ choice of ends, even if those ends lack majority support, but also a confidence in their choice of means, even as to ends the majority have already chosen to advance through the state itself. With respect to means, the majority implicitly believes one of two things: either that groups of fellow citizens will respond to public needs more innovatively, or with greater productive efficiency, than instrumentalities of the state, or that any loss in the meta-benefits of efficiency and innovation are more than offset by gains in pluralism and diversity, which latter benefits are established by the very fact that the program in question is being run by a voluntary association of citizens, not by the state.

The majority’s tolerance, of course, is not unlimited. On relatively rare occasions, they will remove the exemption of an entire “industry,” as in the case of health insurance.⁹⁸ Or they will remove the exemption from

⁹⁸ Tax Reform Act of 1986, Pub. L. No. 99-514, § 1012(a), 100 Stat.

an entire class of charities' activities, like the active conduct of an unrelated trade or business.⁹⁹ Sometimes the majority will be even more severe, punishing engagement in any amount of some activity at all, like political campaigning, or too much of an activity, like lobbying, with loss of an organization's entire exemption¹⁰⁰ and, along with it, its donors' entitlement to donation deductions. Perhaps most significantly, sometimes the people become impatient with charities that are too far from the people, too close to elites of either wealth or expertise—plutocrats or bureaucrats—hence the rigorous private foundation regime enacted with manifest populist motivation in 1969.¹⁰¹

2085, 2390-2391 (adding current IRC § 501(m), which denies charitable status under IRC § 501(c)(3) and social welfare organization status under IRC § 501(c)(4) to organizations like Blue Cross and Blue Shield that provide “commercial-type insurance”). See Hansmann, *Evolving Law*, supra note 50, at 823 (citing IRC § 501(m) as an example of the “fencing out” approach).

⁹⁹ Revenue Act of 1950, ch. 994, § 301, 64 Stat. 906, 947-953; Tax Reform Act of 1969, Pub. L. No. 91-172, § 121, 83 Stat. 487, 568-584; IRC § 511.

¹⁰⁰ 26 U.S.C. § 501(c)(3) (2008).

¹⁰¹ See Federal Tax Treatment, supra note 6, at 279 (“Concern about these foundations – said to be unaccountable ‘shadow governments’ ... -- was clearly on the minds of several congressional committees that appraised foundations in the years leading to the 1969 enactment of the private foundation rules.”) (citations omitted); HOPKINS, supra note 28, at 429 (noting that private foundations are “chastized for being elitist, playthings of the wealthy, and havens of ‘do-gooders’ assuaging their inner needs by dispensing beneficence [sic] to others”).

And there are, of course, questions of exemption at the margin, which the people leave, generally to their satisfaction or at least indifference, to the Internal Revenue Service and the courts. The Service and the courts operate under one plausible exception, more or less of their own making, to the general rule of generous exemption eligibility: although the exemption generally extends to whatever nonprofit activity a citizen believes will benefit the public, it does not extend to activities that are deemed harmful to the public.¹⁰² Thus meta-harms like racial discrimination have been held, in effect, to negate the usual meta-benefits of pluralism, efficiency, and innovation, and even primary benefits like education.¹⁰³ If the courts or the Service are too generous or too chary in granting exemptions, the people's representatives in Congress can always override them, as they did, again, in the case of health insurance.¹⁰⁴

The traditional subsidy theory's odd inability to provide a substantive definition of the public benefit that it holds to be the basis of the exemption and deduction can thus be seen, not as a failure, but as a virtue, a bow toward Tocquevillean philanthropy. Something similar can also be

¹⁰² I use the passive construction – “are deemed” – advisedly, to cover the convolution of that process. It is often the courts that initially determine what fundamental public policy is, and what violates it. But recall, again, that it is ultimately the people who decide; every provision of our constitution, remember, is subject to amendment.

¹⁰³ *Bob Jones Univ. v. U.S.*, 461 U.S. 574 (1983).

¹⁰⁴ *See supra* note 98.

said about traditional subsidy theory's apparent failures both to provide a means of comparing charities, either among themselves or with institutions in other sectors, and to correlate tax subsidies with either the quality or quantity of the good or service provided, once that good passes the low threshold of charitability. When we shift the focus from particular products and the way in which they are provided, these weaknesses begin to look very much like strengths. If the exemption is seen as an artifact of tax-base definition, rather than as a subsidy, then the problem of "fit" disappears.

The charitable deduction, on the other hand, by the very fact that it is structured as a deduction, is nicely tailored to what we want to favor, namely individual donations to what donors themselves believe are publicly beneficial causes. And the deduction has other advantages as well. It gives us a means of ensuring that people put their money where their mouths are, and it has the added individualist virtue of letting each citizen decide, at least to some extent, how public resources are used. We can, and do, adjust that with the deduction's percentage-of-income limits;¹⁰⁵ we could also tailor the deduction to favor the gifts of the poor as much as, or more than, the gifts of the rich, perhaps by replacing the deduction with a credit.¹⁰⁶

¹⁰⁵ IRC Section 170, *passim*.

¹⁰⁶ See Federal Tax Treatment, *supra* note 6, at 279 (discussing criticisms that present system of tax deductions for charitable gifts favors the wealthy and assesses responses and proposed alternatives); WEISBROD, *supra* note 24, at 164-65 (same).

IV. TOWARD AN ALTERNATIVE SYNTHESIS: NEO-CLASSICAL REPUBLICAN PHILANTHROPY

The people's will in a democracy, we have conceded, is like God's will in a theocracy: whatever it is, is right; whatever it seeks, good. In classical normative philosophy, however, another question can always be put, to both the people and the deity: Is it good because they favor it, or do they favor it because it is good?¹⁰⁷ A majority of Americans, at some level, must favor our Tocquevillean system of charitable tax exemption and deduction; they are entirely entitled to change it whenever they like, and presumably, if they disliked it enough, they would.

But that still leaves open the question of whether our system of exemption and deduction is really good, or good for any reason other than its having been democratically chosen. Unless one is a radically reductionist kind of democrat, one can question its merits, in whole or in part. Section A of this Part raises some of those questions, by taking a deeper look at some of Tocquevillean philanthropy's less salient, but profoundly significant, features. Section B offers a very different set of answers; it offers neo-classical republican philanthropy as an alternative to Tocquevillian democratic philanthropy. As we shall see, neo-classical republicanism not only connects

¹⁰⁷ PLATO, EUTHYPRO (F.J. Church, trans., 2d revised ed., 1956).

nicely with our cultural traditions generally; it also better matches de Tocqueville's own political and social preferences.

A. A CRITIQUE OF TOCQUEVILLEAN DEMOCRATIC PHILANTHROPY

Proverbially, one's meat is another's poison. So, in classical political theory, one system's virtues are another's vices.¹⁰⁸ And so it is, this section will show, with Tocquevillean philanthropy. We begin by identifying the kind of state that Tocquevillean philanthropy implies as its ideal complement, the minimalist state of libertarianism. We then note two critical biases that this libertarian leaning implies for philanthropy and its tax treatment. The first is a bias toward philanthropic as opposed to government providers; the second is a bias toward private contributions as opposed to public finance. But this relationship between Tocquevillean philanthropy and libertarianism poses a puzzle: Would not a consistently libertarian position favor abolition of the all tax subsidies to philanthropy?

¹⁰⁸ PLATO, *REPUBLIC* (Allan Bloom, trans., 1968) at 222 ("Do you know ... that it is necessary that there also be as many forms of human characters as there are forms of regimes?"); ARISTOTLE, *POLITICS* 149 (Jowett trans., Modern Library ed., 1943) ("The goodness or badness, justice or injustice, of laws varies of necessity with the constitutions of states."). *See also* CHARLES DE MONTESQUIEU, *THE SPIRIT OF THE LAWS* 13 (Thomas Nugent trans., Great Books ed., 1992) ("The laws of education will be ... different in each species of government: in monarchies they will have honor for their object; in republics, virtue; in despotic governments, fear.").

This question, in turn, brings us to two fundamental points about the much-vaunted value that de Tocqueville placed on philanthropy in America. First, he saw it not as the ideal, but as a distinctly second-best arrangement. Second, he saw it not as a means of advancing the people's will, whatever that might be, but as the only means available to move the America of his day toward what he implicitly took to be the proper end of all societies, what he called "civilization." As we shall see, his civilization was distinctly neo-classical and republican.

*1. The Implicit Libertarianism of
Tocquevillean Philanthropy*

As to comparisons among charities, and between charitable provision and other provision, the current system, again, offers no guidance to individual donors or voters. From a liberal democratic perspective, that silence may be golden. The point to note is simply that it leaves a normative gap here, as is the tendency of liberal democracy in general, under the liberal principle of neutrality toward life-plans. And here that silence is nearly total, which puts the liberalism reflected in our tax treatment of charity near the libertarian, minimal-state, pole of the spectrum of liberal theory. Libertarians prefer the state to be silent on the relative merits of citizens' individual ethical systems.¹⁰⁹

This libertarian tendency of Tocquevillean charity is

¹⁰⁹ See Rob Atkinson, *Re-Focusing Philanthropy*, *supra* note 8, See *supra* Part II.B.2 (describing the relationship between our current system of philanthropy and liberal political theory).

at least as evident in two other respects. It embodies unmistakable preferences on two very important issues.¹¹⁰ The for-profit, governmental, and cultural sectors are, to a very large extent, capable of producing the same goods and services. Thus, for example, organizations in each sector can and do operate elementary schools. So, more generally, funding for subsidized goods and services can come from voluntary contributions or coerced transfers, primarily taxes. Schools for those who cannot afford tuition can thus be funded by taxes or by gifts (or cross-subsidies). Tocquevillean philanthropy embodies a strong preference for both non-governmental provision and donative financing.¹¹¹ We need to look at each bias, then at their interaction.

*a. The Implicit Bias Toward
Philanthropic Over Governmental
Providers*

These libertarian leanings are, in fact, deeply rooted in the meta-benefits at the foundation of the Tocquevillean

¹¹⁰ See Rob Atkinson, *Re-Focusing Philanthropy*, *supra* note 8 (identifying these issues and discussing them in more detail).

¹¹¹ See Lester Salamon, *Partners in Public Service: The Scope and Theory of Government-Nonprofit Relations*, in *THE NONPROFIT SECTOR* 99, 110 (Walter W. Powell & Richard Steinberg eds., 1st ed. 1987) (noting that the phenomenon of “third party government,” provision of publicly financed goods and services through non-governmental suppliers, “reflects ... the conflict that has long existed in American political thinking between the desire for public services and hostility to the governmental apparatus that provides them.”).

account of philanthropies' special tax treatment: "efficiency," "innovation," "pluralism," and "diversity."¹¹² The Code's favorable tax treatment of philanthropy assumes that philanthropic provision of a good or service is superior to governmental provision in one of these four ways. Quite often the virtue is assumed rather than proved.

This is most apparent with philanthropy's supposed promotion of pluralism and diversity. If we take pluralism to be a shorthand for a multiplicity of providers, then, of course, the mere fact that a philanthropic provider is not a governmental provider is, by definition, an instance of pluralism. In many systems, of course, redundancy is a virtue; it is built into many organisms by evolution itself.¹¹³ But redundancy is inherently expensive, and it always pays diminishing returns. What is more, many supporters of philanthropy do not see its institutions as functioning that way at all. They see those institutions, not as "fail-safe" mechanisms, ensuring continuity of service, but as "governments in exile," working to undermine the provision of goods and services by the state, no matter how

¹¹² The literature generally uses the terms "pluralism" and "diversity" as synonymous. For greater clarity, I assign these terms, admittedly somewhat arbitrarily, to two related but distinguishable virtues. By "pluralism" I mean variety of provider, both sectoral and "firm." By "diversity" I mean variety of opinion about the good, both as an end and as the means to that end.

¹¹³ See WEISBROD, *supra* note 24, at 17 ("Different institutional forms have different effects on society; a healthy pluralism is a continuing goal of public policy.").

much more productively efficient state provision may be.¹¹⁴ Many hands may well make light work—but only if they are all lifting the same burden and hauling it in the same direction.

This prospect points to a similarly dubious aspect of philanthropy's contribution to diversity. If by diversity we mean multiplicity of views about the public good and the means of its advancement, both the philanthropic sector itself and the likely variety within it certainly add diversity to the necessarily somewhat monolithic presence of the modern state. Thus, according to one commentator, "The voluntary sector achieves diversity through the very diversity of its institutions."¹¹⁵

But what is true in general may well not be true in every case. In a region where most well-off white children attend white-flight academies, the appearance of yet another white-flight academy, rather than a racially integrated public school, is hardly a triumph for diversity by any less circular definition. Similarly, the opening of a NATO-sponsored secular school in Afghanistan would appear to promote diversity in a very different way from the opening of yet another fundamentalist madrassa

¹¹⁴ See RICHARD CORNUELLE, *RECLAIMING THE AMERICAN DREAM* (1965) (calling for the philanthropic sector to challenge and replace the state as the ensurer of public welfare, on the basis of Goldwater political ideology and upbeat anecdotes).

¹¹⁵ James Douglas, *Political Theories of Nonprofit Organizations*, in *THE NONPROFIT SECTOR* 43, 46 (Walter W. Powell & Richard Steinberg eds., 1st ed. 1987) [hereinafter *Political Theories*].

sponsored by the pet philanthropy of a member of the House of Saud. The automatic equation of charitable provision with increases in pluralism is not merely tendentious; it is perfectly circular.

Pluralism and diversity are often invoked, alone or together, as means toward two other benefits that flow from philanthropy: innovation and efficiency. To ensure innovation and find more efficient means of providing goods and services, the argument implicitly runs, we encourage a multiplicity of providers with a diversity of views on the public good and how to do it. This is rather like Brandeis's notion of the states as "laboratories of experiment" in the solution of social problems. But here again, what is true in general may not be true in every case. In the case of philanthropy, these are laboratories whose protocols are seldom announced, and whose results are never tested. State experiments in social reform sometimes fail; the voters are free to switch to another approach. Philanthropic experiments may similarly fail, and donations may dry up. But a philanthropic organization will never have its exemption questioned by the IRS, much less revoked, for any such failure. The present system of tax preferences gives us no metric for measuring how well a particular philanthropy promotes innovation or efficiency, and no remedy for its failure in that regard.

The virtues of "innovation" and "efficiency," in their turn, prove almost equally biased. In his classic defense of private foundations, my mentor John Simon famously argues for their favorable tax treatment in terms

of their tendency to innovate. He cites several famous examples, including the “Green Revolution” in third-world agriculture.¹¹⁶ But, as the saying goes, anecdotes are not data. We do not know whether the foregone tax revenues left in the hands of even highly innovative private foundations (much less the mill run) produced more public benefits than government entities would have produced with the same funds. Government agencies, remember, include the Centers for Disease Control, the National Endowment for the Arts, and the National Endowment for the Sciences, not to mention every state and municipal college and university in the nation.

Of course, Simon’s examples are not randomly chosen; they are cherry-picked from private foundations’ most salient success stories. Surely even the best foundations sometimes fail in their humanitarian objectives; some do not even pretend to be in the game. Unlike the Rockefeller Foundation’s motto, “for the good of humanity,” many private foundations, like many public charities, devote themselves quite single-mindedly to the glory of God, and at least some of their projects seem rather remotely related to helping His creatures here below.

What is more, charity has two distinctly anti-innovation elements built deeply into its basic structure. As Hansmann has indicated, charities’ lack of access to equity investment slows their entry into areas of increasing

¹¹⁶ John Simon, *Charity and Dynasty Under the Federal Tax System*, 5 PROB. LAW. 1 (1978).

consumer demand.¹¹⁷ Hansmann has also demonstrated a parallel problem in the other direction, when demand for their goods and services are declining. In industries marked by diminishing demand, the locking of charitable assets into the original purpose to which they were dedicated can make the movement of their capital out of that industry and into another quite slow and expensive. This means that, in a dynamic economy, charity responds relatively slowly—in economic terms, inefficiently—to shifts in consumer demand.¹¹⁸

The case for charity's superior innovativeness, though often asserted, is thus yet to be proved. As others have noted, "it is plausible to celebrate nonprofits as a major source of social innovation ... It is less clear whether nonprofits (other than perhaps social movement organizations) actually do serve that function."¹¹⁹ It is more than a little odd to begin a paragraph with "the voluntary sector has fulfilled the role of experimenter and initiator with distinction in the past," only to conclude it with, "we need much firmer empirical evidence before we can determine how the sector is fulfilling its initiating and

¹¹⁷ Exempting Nonprofit Organizations, *supra* note 24.

¹¹⁸ See Henry Hansmann, Daniel Kessler & Mark McClellan, *Ownership Form and Trapped Capital in the Hospital Industry*, in *THE GOVERNANCE OF NOT-FOR-PROFIT ORGANIZATIONS* 45 (Edward L. Glaeser ed., 2003).

¹¹⁹ Smith & Gronberg, *Government-Nonprofit Relations*, *supra* note 95, at 224.

experimental role in social policy.”¹²⁰

This points to a much larger problem: claims for charitable efficiency are even more dubious than claims for charities’ innovativeness. Sometimes, as we have seen, charities are demonstrably more efficient, either productively or economically, than alternative producers.¹²¹ Teaching orders of religious institution may attract more devoted teachers than public schools; in the provision of products involving various forms of market failure, as Hansmann has shown, nonprofit suppliers predictably outperform their for-profit counterparts. Notice, though, that this latter advantage is relative to for-profit suppliers, not to government;¹²² as Hansmann concedes, government provision of a good or service is, at least in theory, another

¹²⁰ Political Theories, *supra* note 115, at 48-49.

¹²¹ See Salamon, *supra* note 111 (“[T]he extensive pattern of governmental support of nonprofit institutions ... permits a degree of diversity and competition in the provision of publicly funded services that can improve efficiency and reduce costs.”); see also WEISBROD, *supra* note 24, at 25 (“In some cases a more decentralized, nongovernmental institutional mechanism, such as the nonprofit, may have better access to diverse, localized information, thereby overcoming some of the problems of over- and underutilization.”).

¹²² See WEISBROD, *supra* note 24, at 25 n.30 (faulting Hansmann for having “seemingly overlooked the fact that the nondistribution constraint is binding on governmental as well as private nonprofit corporations,” which means that “information asymmetries are a potential justification for society choosing a form of institution other than a for-profit, but they are not a sufficient basis for choosing between government and nonprofits.”).

alternative to contract failure in the for-profit sector.¹²³ His theory is not meant as a means of making the comparison between government and charitable suppliers.

Even in the comparison of charitable to for-profit suppliers, Hansmann notes a serious problem.¹²⁴ The nondistribution constraint, which tends to ensure the greater economic efficiency of charities in industries exhibiting contract failure, also tends to discourage productive efficiency across the board. With no residual owners eager to increase profits by lowering costs, charities are especially susceptible to shirking. Any economic efficiency gains may thus be lost to productive efficiency losses. We cannot know *a priori* which tendency will prevail. But, under the current tax regime, the question is never asked. A charity need neither prove its superior efficiency in advance nor demonstrate it in operation in order to qualify for the exemption of its income; a charity is in effect simply presumed to be more efficient, economically or productively, than government provision.¹²⁵

¹²³ See Economic Theories, *supra* note 42, at 30; Nonprofit Enterprise, *supra* note 39, at 868-72.

¹²⁴ See Economic Theories, *supra* note 42, at 38; Nonprofit Enterprise, *supra* note 39, at 878.

¹²⁵ Sometimes this focus on institutional form as a proxy for superior output is appropriate, as, for example, where the transaction costs of directly monitoring output are prohibitively high. See WEISBROD, *supra* note 24, at 47 (identifying this general situation). But no such calculation has actually been made in the case of tax exemption and deduction as to either philanthropy as a whole or particular kinds of philanthropy.

That is neither the end of the matter nor the worst. A closer look at the asserted efficiency of nongovernmental suppliers in general, and nonprofit suppliers in particular, reveals a most peculiar means of reckoning efficiency. James Q. Wilson makes this point nicely with the example of Donald Trump's reconstruction of Central Park's ice-skating rink in the face of the city's apparently excessive delays. By a simple measure of productive efficiency, Wilson notes, Trump's private enterprise was clearly superior to the city's own efforts: "If the valued output is a rebuilt skating rink, then whatever process uses the fewest dollars or the least time to produce a satisfactory rink is the most efficient process."¹²⁶ But, Wilson points out, this approach "assumes that there is only one valued output, the rink," when in fact "government has many valued outputs, including a reputation for integrity, the confidence of the people, and the support of important groups."¹²⁷ Thus "a government that is slow to build rinks but is honest and accountable in its actions and properly responsive to worthy constituencies may be a very efficient government, if we measure efficiency in the large by taking into account all of the valued outputs."¹²⁸

¹²⁶ JAMES Q. WILSON, *BUREAUCRACY: WHAT GOVERNMENT AGENCIES DO AND WHY THEY DO IT* 317 (1989).

¹²⁷ WILSON, *supra* note 126, at 317; *see also* Political Theories, *supra* note 115, at 46 ("[T]he state's distribution of benefits must not only be equitable; it must also be seen to be equitable.") (emphasis in original).

¹²⁸ WILSON, *supra* note 126, at 318; *see also* WEISBROD, *supra* note 24, at 34 ("If public and private producers did not provide essentially

Burton Weisbrod expands this point to include nonprofit suppliers:

When proprietary, governmental, and nonprofit sellers coexist, they are likely to produce systematically different types of services or distribute them in different ways, but when costs are compared, the private firm is considered the standard of comparison. Nonprofit and governmental organizations may provide more outputs in forms that the private market does not reward. If society wants to encourage production of these outputs, these institutional alternatives to the private market have a place.¹²⁹

But calculating this “efficiency in the large,” Wilson points out, entails two serious problems. In the first place, we have no satisfactory means of measuring these other, secondary outputs, a problem that Weisbrod also identifies.¹³⁰

identical outputs, their costs might well differ, but we could not say that one producer was more cost efficient than the other.”); *id.* at 38 (“Cost efficiency cannot be compared when the bundle of outputs is different.”).

¹²⁹ WEISBROD, *supra* note 24, at 37.

¹³⁰ See WEISBROD, *supra* note 24, at 46 (“It is difficult to gauge the success of governmental and nonprofit organizations in providing

Much more seriously, we do not all agree that these other outputs are, in fact, good in the first place.¹³¹ Lester Salomon has shown that at least some of the supposedly superior efficiency of charities compared to government trades on precisely these problems.¹³² Much of what proponents of charitable efficiency count as costs of government “red tape” and other inefficiencies are actually the kind of secondary outputs Wilson identifies: civil service protections for employees and procedures designed to implement “process values” like transparency. As even its proponents recognize, in arguments about charitable avoidance of “red tape,” “the term has been used to indicate almost anything from a generalized dislike of any form of regulation to specific cases of maladministration.”¹³³

services with hard-to-measure attributes.”).

¹³¹ WILSON, *supra* note 126, at 318. *Cf.* WEISBROD, *supra* note 24, at 41 (“We care not only about producing janitorial services and coal, but also about providing decent employment opportunities and earnings rather than welfare or unemployment insurance.”).

¹³² Salamon, *supra* note 111, at 99, 110-11. *See also* Smith & Gronberg, *supra* note 95, at 229 (“Ultimately, the transactional model [of Salamon and others] may also raise questions about the extent to which government contracting of services effectively amounts to a diversion of government power to providers and whether providers are subject to all the constraints about equity and fairness that apply to government.”).

¹³³ Political Theories, *supra* note 115, at 50. As Musgrave & Musgrave have observed,

Once more, quite different connotations can be ascribed to the same institution. On the one side, we have self-serving “bureaucrats,” who seek to maximize their power and/or

From this perspective, what presents itself as a preference for productive efficiency may be something else entirely. It may, instead, be a bias against secondary output of government provision; government soup kitchens and schools supply not only bread and education, but also workers with civil service protection, pensions, and other publicly approved working conditions. What is more, public schools tend to be “soft” on subjects like evolution and human sexual activity and preferences. This latter observation leads to a more general point: preferences for charity may be a bias in favor of secondary outputs of charitable provision. Charitable providers can say, “We feed the hungry and educate the poor, not on the third principle of modern republicanism, fraternity, but in the name of the Holy Trinity.” Or, more generally, preference for charity may simply be a bias against government itself: “We, the providers of this bread, are not they, the servants of the republic.”

All these preferences for charity over the state, of course, shape our culture; if we get what we cannot find or afford in the market from charity rather than the state, we come to expect it from charity rather than from the state. Thus the charitable sector grows, qualitatively and quantitatively, at the expense of the state. Predictions of the

income, as determined by the size of their bureaus. On the other, we have the dedicated “civil servant,” who seeks to contribute to the efficient operation of the public sector and to the public interest.

Musgrave & Musgrave, *supra* note 79, at 122-23.

superiority of charity—its greater efficiency, its higher quality—become self-fulfilling prophecies.

As Weisbrod long ago observed, “[p]erformance’ can be rewarded appropriately only if it can be measured appropriately.”¹³⁴ We have, since then, made virtually no progress in developing the appropriate measures for comparing institutional performance, yet we continue to subsidize philanthropic provision of essential goods and services. The tax system’s preference for philanthropic provision reflects demonstrably anti-statist, even libertarian, tendencies that are not wholly apparent on its face but profoundly important in its cultural implications. As we shall see in the next subsection, the tax system’s preference for voluntary financing is, if anything, even more troubling.

*b. Implicit Bias Toward Financing
with Private Contributions Instead of
Taxes*

Tocquevillean philanthropy is biased against not only state provision of goods and services through its own agency, but also public financing of goods and service, without regard to the provider. The basic problem with financing through voluntary contributions is this: that system taxes civic virtue and, conversely, subsidizes social shirking. This notion of charitable financing of public services as a surtax on donors’ virtue is a generalization of my previous critique of pro bono publico legal services as

¹³⁴ WEISBROD, *supra* note 24, at 44.

the preferred means of meeting the legal needs of the poor.¹³⁵ Consider again the case of public elementary schools. Every fall, in schools across the land, the call goes out, from individual teachers and from central administrations, for basic school supplies, or the money with which to buy them. Presumably, those who respond to the call are those who can afford to; so far, so good.

Let us focus, instead, on those who do not respond. Some, of course, are simply too poor; others are quite able to respond, but not especially forthcoming. They are, in effect, free-riding on the parents who do, in fact, pay. Those paying parents are, then, paying twice: not just their “share,” but also the share of parents who are able but not willing to pay (or thrice, if we count the share of those parents who cannot afford to pay). If, by contrast, the schools’ necessary supplies were paid for with tax revenues, the poor could be exempted and the burden placed on all parents who are able, whether or not they are willing. Voluntary financing shifts the burden to parents both willing and able; it is thus a peculiar, if not perverse, surtax on their civic virtue.¹³⁶

¹³⁵ This notion of charitable financing of public services as a surtax on donors’ virtue is the generalization of my critique of pro bono publico legal services as the preferred means of meeting the legal needs of the poor. See Atkinson, *Pro Bono Publico Representation of the Poor: The Good as Enemy of the Best*, 9 J. OF GENDER, SOCIAL POLICY, AND THE LAW 129 (2001) (symposium issue).

¹³⁶ See WEISBROD, *supra* note 24, at 30 (“The undersatisfied high demanders of collective goods may be the people for whom the sense

Such examples could, of course, be multiplied almost at will; it does not strain credulity too much to imagine that the same parents who supplied chalk and construction paper yesterday are the ones shipping body armor to their sons and daughters in Iraq today. These are not, however, worst-case scenarios; both these cases involve at least some measure of public provision. Few openly doubt we should have a public army, and only a vocal minority questions whether we should have public schools.¹³⁷

As this last example suggests, opposition to public financing of goods and services may well coincide with opposition to public provision of those services. Behind proponents of vouchers for privately operated schools, at least some suspect opposition to public financing of education as well. Lest one doubt that these doubters of public schools will ever amount to much, consider the historical case of Prince Edward County, Virginia. Faced with federal court orders to desegregate their county

of social responsibility is strongest; while they would prefer that more people shared their intensity of concern about certain collective goals, they may feel that their own obligations are not diminished by the lower intensity of others' contributions.").

¹³⁷ See Political Theories, *supra* note 115, at 47 ("Only in the last hundred years or so has education become sufficiently widely recognized as a universal right for the state to provide education as a service financed by compulsory taxation... [so that] today some form of education, at least at the secondary level, is provided as a free service in all advanced industrial countries.").

schools, the white majority of citizens hit upon an ingenious alternative: close the county schools.¹³⁸ For years, relatively affluent white children went to a segregated private school; relatively poor white children and virtually all the African American children either did not attend school or attended a second private school, staffed mostly by volunteers and funded by donations. Strictly speaking, the “Free School” of Prince Edward County is a textbook example of both “market failure” and “government failure.”¹³⁹ All demand for public schools was “supra-majority”; the white majority of the county’s citizens unmistakably (and unabashedly) preferred no public schools to integrated public schools. Meanwhile, donors to the Free School found a nonprofit to be the best vehicle through which to meet their demand for the education of African American and poor white students.

The sorry tale of Prince Edward County’s schools may, of course, be the exception that proves the rule. The question is: which rule? All across the South, in counties

¹³⁸ *Griffin v. County School Board of Prince Edward County*, 377 U.S. 218 (1964).

¹³⁹ See Political Theories, *supra* note 115, at 47-48 (“Although segregation has a pejorative connotation, it is not inconceivable that some people should put a positive social value on allowing children to be educated among their coreligionists, and although it is more difficult to imagine people putting a positive social value on social and ethnic segregation, it is likely that different elements in a diverse population will reach different will value judgments regarding the trade-offs between divisiveness and academic achievement.”).

with white majorities and large African American minorities, a more or less similar pattern repeated itself. Affluent white parents formed private schools, leaving poorer whites and most African Americans in poorly-funded public schools. The new academies were often formally segregated, but not always; at most, the ones that were nominally non-discriminatory could expect to enroll a tiny handful of African American children from relatively affluent professional or entrepreneurial families.

In the North, of course, the pattern was different, as it was in much of the urban South. Segregation above the Mason-Dixon Line, and eventually in larger Southern cities, was generally geographic, not legal; the problem there became "inner city schools." Not to put too fine a point on it, the Kennedys and their ilk sent their kids to Choate and Exeter, then Harvard and Yale, shaking their heads, if not wagging their fingers, at Southern bigotry; their less economically fortunate fellow Bostonians wrote the saga of Roxborough bussing.

2. *De Tocqueville's Faux de Mieux Philanthropy*

This last critique is the most significant; here we need to see that de Tocqueville's own praise of American philanthropy was profoundly qualified. It was, he quite clearly believed, the best we Americans could do; it is not at all clear that he believed it best by any other standard. De Tocqueville wrote *Democracy in America* in the 1830s, nearly a century before the New Deal, not to mention the

GI Bill and the *Brown* decision; he cannot fairly be faulted for failing to foresee these later developments. By his lights, America was, in its very essence, a democracy, without the mixed blessings of England's hereditary nobility or France's always powerful, sometimes terrible, state apparatus.¹⁴⁰ Ours, of course, was not a very liberal democracy at that: women were disenfranchised, African Americans were enslaved, states had established religions. De Tocqueville's praise of the central role of voluntary associations in American culture was grounded, we need to note, in the premise that Americans could get the goods and services they provided no other way. He saw America's dependence upon private associations, not as the best imaginable social order, but the best that America could possibly achieve.

Behind what he remarked to be Americans' astonishing inclination to form associations as the response to the full range of perceived social problems, de Tocqueville noted a distinctive element of the American national character:

¹⁴⁰ See de Tocqueville, 2 *Democracy in America* Ch. 5, *supra* note 95, ("Wherever at the head of some new undertaking you see the government in France, or a man of rank in England, in the United States you will be sure to find an association."). See also Smith & Gronberg, *supra* note 95, at 223 ("[S]ocieties with very centralized political structures such as France or the United Kingdom will have very different government-nonprofit sector relations than countries with decentralized political systems such as the United States.").

The citizen of the United States is taught from infancy to rely upon his own exertions in order to resist the evils and the difficulties of life; he looks upon the social authority with an eye of mistrust and anxiety, and he claims its assistance only when he is unable to do without it. This habit may be traced even in the schools, where the children in their games are wont to submit to rules which they have themselves established, and to punish misdemeanors which they have themselves defined. The same spirit pervades every act of social life.¹⁴¹

It was this engrained sense of self-reliance and distrust of government that made the promotion of private associations, in de Tocqueville's view, critical to American democracy:

Nothing, in my opinion, is more deserving of our attention than the intellectual and moral associations of America. The political and industrial associations of that country strike us forcibly; but the others elude our observation, or if we discover them, we understand them imperfectly because we have hardly ever seen anything of the kind.

¹⁴¹ De Tocqueville, 1 *Democracy in America*, Ch. 12, *supra* note 2.

It must be acknowledged, however, that they are as necessary to the American people as the former, and perhaps more so. In democratic countries the science of association is the mother of science; the progress of all the rest depends upon the progress it has made.

Among the laws that rule human societies there is one which seems to be more precise and clear than all others. If men are to remain civilized or to become so, the art of associating together must grow and improve in the same ratio in which the equality of conditions is increased.¹⁴²

Given American culture's entrenched dislike of government, and American law's constitutional rejection of a hereditary aristocracy, promoting private associations was, in his view, America's only way out of a kind of Cyclopean semi-barbarism. Reliance on private associations was thus not America's best way to become, or remain, civilized; it was our only way, a Hobson's choice, not a Utopian alternative. In that, de Tocqueville's thinking was implicitly Aristotelian; his virtues were functions of the institutional arrangements he thought we Americans

¹⁴² De Tocqueville, 2 *Democracy in America* Ch. 5, *supra* note 95.

could not transcend.¹⁴³ He knew that the “ought” implies the “can”; surely he also knew that *le mieux est l'ennemi du bon*.

B. AN OUTLINE OF NEO-CLASSICAL REPUBLICAN PHILANTHROPY

There is another, much more significant, sense in which de Tocqueville's vision of the role of private associations in American democracy is Aristotelian. As we have seen, he believed private associations to be the only way for our country, given its historically conditioned bias against public institutions, “to remain civilized or to become so.” This latter phrase necessarily implies that de Tocqueville has an end in view, a goal for all societies, including our democratic society, which is not to be reduced, even in our democracy, to what the people, or the majority of the people, want. For de Tocqueville, child of the Enlightenment and the Classics that he was, that end is civilization, “to be or become civilized.” In giving that end content, he most assuredly looked beyond America's Jacksonian democracy, back to Europe, and back to Europe's past, particularly to its classical, Greco-Roman

¹⁴³ See ARISTOTLE, *POLITICS*, *supra* note 108, at 149 (“The goodness or badness, justice or injustice, of laws varies of necessity with the constitutions of states.”); see also PLATO, *REPUBLIC*, *supra* note 108, at 222 (Allan Bloom ed. and trans.) (“Do you know... that it is necessary that there also be as many forms of human characters as there are forms of regimes?”).

past.¹⁴⁴ In this final part, we need to look first at how that tradition has itself shaped American institutions, and what that tradition, in its American incarnation, might mean for a very different relationship between philanthropy and the state.

1. America's Neo-Classical Republican Tradition

De Tocqueville wrote, we must remember, in the era of Jackson's racist and rowdy populist democracy,¹⁴⁵ scornful of both Hamilton's Bank of the United States and Marshal's principle of judicial review. Had he looked only a bit further back in America's own past, he would have seen better evidence of quite a different culture, a culture

¹⁴⁴ Thus, in commending the study of classical literature to America writers, and to modern writers generally, de Tocqueville said:

All who aspire to literary excellence in democratic nations ought frequently to refresh themselves at the springs of ancient literature; there is no more wholesome medicine for the mind. Not that I hold the literary productions of the ancients to be irreproachable, but I think that they have some special merits, admirably calculated to counterbalance our peculiar defects. They are a prop on the side on which we are in most danger of falling.

Alexis de Tocqueville, 2 *Democracy in America*, Ch. 15, University of Virginia Hypertexts Project, http://xroads.virginia.edu/~HYPER/DETOC/ch1_15.htm (last visited Mar. 11, 2010).

¹⁴⁵ See Peter Dobkin Hall, *A Historical Overview of the Private Nonprofit Sector*, in *THE NONPROFIT SECTOR: A RESEARCH HANDBOOK* 3, 8 (Walter W. Powell ed., 1st ed. 1987) (noting that de Tocqueville's writings reflected Jacksonian era).

itself more supportive of both Classical and Enlightenment values. In recounting Americans' aversion to government, he seems not to have noticed the role of the state in the early development of some of the most "Ivy" of our universities, not least Harvard and Yale.¹⁴⁶ In that respect,

¹⁴⁶ Thus, as Lester Salamon points out,

In colonial Massachusetts, for example, the commonwealth government not only enacted a special tax for support of Harvard College but also paid part of the salary of the president until 1781 and elected the college's Board of Supervisors until after the Civil War. The state of Connecticut had an equally intimate relationship with Yale, and the state's governor, lieutenant governor, and six state senators sat on the Yale Corporation from the founding of the school until the late 1800s.

Salamon, *supra* note 111, at 99-100; see also Peter Dobkin Hall, *A Historical Overview of Philanthropy, Voluntary Associations, and Nonprofit Organizations in the United States, 1600-2000*, in *THE NONPROFIT SECTOR: A RESEARCH HANDBOOK* 32, 34 (Walter W. Powell & Richard Steinberg eds., 2d ed., 2006) ("Such institutions as Harvard, William and Mary, and Yale were regarded [in colonial America] as public corporations, subject to legislative oversight and supported significantly in the form of legislative grants of money, real estate, and 'privileges' (which could range from the levying of special taxes to a monopoly on the operation of ferries)."); *id.* at 39 ("Both Harvard and Yale, with significant representation of elected officials on their governing boards, were not private as we understand the term, though both would replace the *ex officio*s with elected alumni representatives by 1870.").

they quite closely and consciously reflected similar synergies and hybrid origins in the histories of all of the great universities of Europe—Oxford, Cambridge, Edinburgh, and the Sorbonne.¹⁴⁷

More significantly for America's future, de Tocqueville might have taken greater notice of Thomas Jefferson's alma mater, the College of William and Mary, and his fondest legacy, the University of Virginia. William and Mary was founded very much on the European University model, as a hybrid of public and private funding and control.¹⁴⁸ The University of Virginia was both more neo-Classical and more republican. It was a creature of the Commonwealth of Virginia, and it was to be the capstone of a universal system of publicly funded education.¹⁴⁹ In a few years, it became the model for state universities across much of the South.¹⁵⁰

Perhaps we can now appreciate that de Tocqueville

¹⁴⁷ See Political Theories, *supra* note 115, at 48 n.10 (noting that “many schools, universities, and hospitals were established in medieval times” and that “it is a moot semantic point whether these should be classified as voluntary organizations.”).

¹⁴⁸ See Hall, *supra* note 145, at 34 (discussing William and Mary as a public institution in the colonial era).

¹⁴⁹ DUMAS MALONE, JEFFERSON AND HIS TIME: THE SAGE OF MONTICELLO 243 (1981) (“[T]he goal he hoped ultimately to reach was the establishment of a state-wide system of public education that would provide instruction at all levels.”).

¹⁵⁰ See Hall, *supra* note 145, at 35 (“Southern states, influenced by Jefferson’s concern about ‘un-republican’ institutions, were particularly hostile to private corporations, associations, and charities.”).

should have looked ahead as well. In the perspective of the populist era in which he wrote, even as de Tocqueville could not see back to Jefferson the Republican, so too he could not see ahead to Lincoln the Whig, advocate of an activist government, state and national, much less Lincoln the Republican, public opponent of popular sovereignty on the question of slavery (and probably private opponent of popular sovereignty *tout court*). His Grand Army of the Republic neither defended America against foreign invaders nor secured its independence from a distant prince. It crushed the effort of the legally enfranchised voters of the Southern states to establish, by majority vote, an independent nation of their own, even as their forebears and Lincoln's had done.

Lincoln's may have been a vision of government "of the people, by the people, and for the people," but not without serious qualifications. He meant not to follow popular whim, but to lead the people to a higher sense of themselves, individually and collectively. On the eve of the Union's unconditional triumph, in his second inaugural address, he commended the people to "the better angels of our natures." To ensure that the Union triumphed, and triumphed unconditionally, Lincoln's administration suspended the writ of habeas corpus, aggressively suppressed the rival press, and dispatched troops to New York and other northern cities to press reluctant citizens into the Grand Army of the Republic.

Lincoln the Republican, remember, was not only the author of the Emancipation Proclamation and the savior

of the Union. He was also the signer of the Morrill Act, which established the land-grant college system. Remember too, that the land grant colleges now count among their number not just my grandfather's Clemson and my brother-in-law's North Carolina State, but also the Ivy League's Cornell. Designed to focus on agricultural and mechanical subjects, very much as de Tocqueville would have recommended,¹⁵¹ all land grant colleges eventually

¹⁵¹ De Tocqueville's views on education in a democracy were hardly what we would call democratic:

It is evident that in democratic communities the interest of individuals as well as the security of the commonwealth demands that the education of the greater number should be scientific, commercial, and industrial rather than literary. Greek and Latin should not be taught in all the schools; but it is important that those who, by their natural disposition or their fortune, are destined to cultivate letters or prepared to relish them should find schools where a complete knowledge of ancient literature may be acquired and where the true scholar may be formed. A few excellent universities would do more towards the attainment of this object than a multitude of bad grammar-schools, where superfluous matters, badly learned, stand in the way of sound instruction in necessary studies.

2 Democracy in America, Ch. 15, *supra* note 144.

developed liberal arts majors and required humanistic courses even for students in their more “practical” programs. Nor did this development cost them their popular support or public subsidies.

The federal court order that admitted James Meredith to the University of Mississippi, like the GI Bill that funded my father’s veterinary studies and flooded the Ivy League with students far more diverse than their pre-war Yankee clientele, were, in one sense, distinctly egalitarian: they struck down or at least diminished, directly or indirectly, distinctions of race, creed, ethnicity, and even wealth. In one sense, they were also basically democratic, the GI Bill distinctly so: it was passed by the national Congress. The federal desegregation of Ole Miss, much less obviously so: it was under the orders of the courts, our government’s counter-majoritarian branch. But the troops were National Guardsmen, not federal marshals, and they were ordering in by the elected President, not appointed judges. We must remember that even the federal judges could not have legally withstood popular discontent had it been as wide in the nation as it was deep in the South. A majority of Americans can always amend the Constitution and thus overrule the courts.

Yet, in an even deeper and more significant sense, the GI Bill and the desegregation orders were neither egalitarian nor democratic, but meritocratic and republican. The doors that they opened, literally and figuratively, were the doors of universities. Even after the invidious, extraneous bars of race, religion, and poverty had been

removed, one essential, salutary bar remained: individual merit. To attend the college of their choice, James Meredith, my father, and your parents or grandparents had to pass more or less rigorous admissions requirements. In that sense, universities are distinctly undemocratic; no adult citizen can be denied a vote in a liberal democracy, but many are regularly denied seats in our public universities. Even after admission, a student's success depends on non-democratic and non-market criteria. The student body does not vote on the curriculum, nor are individual students entirely free to choose what courses in the curriculum they will take. They follow a prescribed course, a course traditionally set to include at least a basic knowledge of the culture of the West, if not the world, all the way back to the beginning.

That tradition of liberal education, of course, has been gravely damaged by the cultural radicalism of the 1960s and 1970s, the fundamentalism and multiculturalism of the 1980s and 1990s, and it may well succumb to the consumerism and fiscal crises of the 2000s and 2010s. At least for now, the great bulk of our universities, public and private, secular and religious, are recognizable as the lineal descendants of Plato's academy and Aristotle's lyceum, of either Jefferson's University of Virginia or the Puritans' Harvard and Yale Colleges. Our universities, that is to say, have long been supported, quite generously until relatively recently, by a majority of our citizens, including many who never had the ability or the opportunity to attend university themselves.

What is my point? American democracy need not be indifferent to merit, even excellence. Our democracy, in our parents' time if not our own, has proved itself capable of promoting a distinctly non-populist, non-consumerist institution: the traditional Western university. And that gives us reason to hope, if not expect, that our democracy, properly prompted by "the better angels" of our philanthropic sector, may yet still choose to further distance itself from Jacksonian populism and modern consumerism, yet more fully to re-make itself in the image of Jefferson and Lincoln's neo-classical republicanism.

2. Neo-Classical Republican Philanthropy

On the foundation of this solidly American tradition, it is eminently possible to build a model of neo-classical, republican philanthropy. I have, in fact, set out just such an alternative philanthropic vision elsewhere.¹⁵² What remains to be done here is to summarize that alternative vision very briefly, then to outline its implications for the federal income tax treatment of philanthropy.

a. Neo-Classical Republican Philanthropy in a Nutshell

This alternative vision of philanthropy is neo-classical in two related senses. First, it adopts the traditional subsidy theory's two-part understanding of philanthropy's publicly beneficial function: On the one hand, to ensure that the neediest receive the basic

¹⁵² Atkinson, *The Future of Philanthropy*, *supra* note 8, at 2.

necessities of life, and on the other, to encourage the highest forms of human excellence. Second, it interprets both halves, relief of need and promotion of excellence, in neo-classical terms, traceable back through America's republican origins to the Greco-Roman classics themselves.

This second kind of neo-classicism has several implications. One is its focus on a particular vision of human excellence, the most fully developed individuals in service of the public good. This is, of course, the model of Plato and Aristotle; one could find no better exemplars than Thomas Jefferson and Abraham Lincoln. Second, the principal focus of its relief program would be to ensure that no Lincoln fails to achieve his or her potential on account of humble origins. Every Lincoln, on this model, would be the beneficiary of the kind of subsidized public education that Jefferson envisioned. With Jefferson, in other words, neo-classical philanthropy would reject the libertarian myth that Lincoln was born in a log cabin he built with his own hands. Thus, the relief of distress and promotion of excellence are essentially different aspects of the same neo-classical republican goal: enable everyone in the Republic to become a leader of the Republic.

As this reference to Jefferson's educational ideal suggests, this neo-classical version of philanthropy would have no particular preference for philanthropic as opposed to state provision of essential services, either in the form of the relief of distress or the promotion of excellence. It would, in other words, seek the most efficient provider in terms of real productive efficiency, without the current

system's heavy hand on the private side of the scale. Moreover, it would have a preference for public rather than private funding, taking into account the above analysis of the fundamental unfairness of private funding's "double tax" on virtue.

Finally, like both Classical republican philosophers and the founders of the American republic, neo-Classical republican philanthropy would be essentially secular, though not necessarily atheistic.¹⁵³ Any argument in favor of a particular form of relief or promotion of excellence would have to be made in secular terms. Private religious opinions and purported divine revelations would be respected, even legally protected, but they could not form the basis of the laws of the Republic.

*b. Neo-Classical Republican
Philanthropy and the Federal
Income Tax*

The neo-classical republican philanthropy outlined here implies a very different treatment under the federal income code from the Code's present preferential treatment of Tocquevillean philanthropy. The most salient differences would be on the points at which our neo-classical critique found the current system to be most problematic: its constitutionally suspect subsidy of religion, its explicit

¹⁵³ As I argue elsewhere, the same values that inform neo-classical republicanism can easily be found in the Scriptures and traditions of the West's three Abrahamist faiths, Judaism, Christianity, and Islam. See Atkinson, *The Future of Philanthropy*, *supra* note 8.

embrace of alternative visions of the public good, its implicit assumption of the efficiency of private service providers, and its implicit preference for funding public benefits with private donations instead of progressive taxes. This Section briefly considers a reform on each point in favor of neo-classical republican philanthropy, and then assesses the likely net effect of these reforms and what that, in turn, tells us about the way ahead.

(1) Removing the Subsidy of Religion

Tax subsidies of religious organizations, as we have seen, stand in considerable tension with the First Amendment's Establishment Clause. In upholding the deduction and exemption as applied to religious organizations against Establishment Clause challenges, the Supreme Court conceded that this favorable treatment was in fact a subsidy, only to declare, with no clear or limitable rationale, that this particular kind of subsidy passed constitutional muster.

Neo-classical republican analysis would reject this compromise and treat the exemption and deduction as improper support of religion under the Establishment Clause. This would, of course, hardly be a politically popular position; that, we need to remind ourselves, is why we have a constitution, why our regime is, at least in some significant respects, already recognizable as a neo-classical republic, not a pure populist democracy.

(2) Removing the Subsidy of Non-Religious Ideological

Organizations

But this denial of subsidies to religious organizations flows, not just from a stricter reading of the Establishment Clause, but also from two other and more general considerations. In the first place, neo-classical republicanism would draw different normative conclusions from those of the standard model's efficiency-based insight that the provision of all comprehensive normative schemes, secular as well as religious, are undersupplied because they are all public goods. Since neo-classical republicanism is not committed, without further analysis, to subsidizing consumer demand not met by the market, it would not call for an automatic subsidy of nonprofit organizations committed to promoting such ideologies. Indeed, since neo-classical republicanism has an ethics and politics of its own, it would be, if anything, ambivalent about subsidizing alternatives without some clear evidence to back their promises of public benefit. They would be allowed to flourish with the full protection of the law, but they would not be subsidized by the state.

In fairness, this denial of subsidies would extend even to those philanthropic organizations that themselves embrace neo-classical republicanism. This, in turn, takes us back to the denial of the exemption and deduction to religious organizations. As we have seen, that denial could easily rest on a consistent application of Establishment Clause principles without reference to neo-classical republicanism. Here we can see that denial as also grounded in a broader neo-classical republican principle,

ambivalent about state support of all ideological organizations. It is worth noting here that the present system has long been at best ambivalent about non-religious ideological organizations. Its ill-conceived effort to distinguish between exempt “educational” organizations on the one hand and non-exempt “ideological” organizations¹⁵⁴ would, under neo-classical republican analysis, simply be abandoned.

*(3) Increasing Scrutiny of
Private Philanthropic
Providers*

With respect to all other kinds of service providers, matters would stand quite differently. Tocquevillean private philanthropy’s providing for the poor and promoting excellence displaces the state in those very functions. These functions, on neo-classical republican principles, are the state’s primary responsibility.¹⁵⁵ From that perspective, the current system’s indiscriminate subsidy of such private provision is counterproductive, if not perverse. That is not to say, however, that no state subsidy of private philanthropy would ever be appropriate; quite the contrary.

¹⁵⁴ Compare Big Mama Rag (pro-lesbian advocacy organization recognized as exempt) with National Alliance (pro-Nazi organization denied exemption as ideological).

¹⁵⁵ See WEISBROD, *supra* note 24, at 31 (1988) (noting that “the effect of a donation ... on the level of tax-financed governmental expenditure is not yet known” and that “increased private donations may decrease what government would otherwise have done”).

The critical difference here is that all the presumptions of the current system would be reversed. Thus, provision of goods and services other than those the state itself provides would be presumed ineligible for subsidy (though of course legally protected). As to goods and services the state itself provides, the state would be presumed to be both the more appropriate provider and the more efficient provider. Other providers, again, would be legally protected, but, to qualify for a subsidy, they would have to show themselves more efficient than, or otherwise superior to, the state, by the state's own neo-classical republican standards. In that way, private philanthropy could continue what, on neo-classical republican principles, has always been among its most vital roles: educating the state in better ways to serve the truly public purposes of philanthropy.

(4) *Replacing Private
Financing of Public Benefits
with Progressive Taxation*

The current system's generous definition of charity, as we have seen, reflects Tocquevillean democracy's suspicion, not only of the state as the provider of public benefits, but also of taxation as the appropriate means of financing those benefits. Subsidizing private philanthropic provision, then, is doubly favorable in our current Tocquevillean fiscal system. Conversely, it would be doubly suspect in the alternative neo-classical republican system. That system's strong aversion to the current

system's "double tax" on virtue¹⁵⁶ thus underlies all of the previously identified reasons for contracting the charitable exemption and deduction in favor of direct government provision, financed by progressive income taxation.

(5) The Net Effects of Neo-Classical Republican Reforms and the Problem of the Second Best

The net effects of moving from the present subsidy of Tocquevillean philanthropy to a system of neo-classical republican philanthropy would be both a substantially smaller philanthropic sector and a substantially more restricted charitable exemption and deduction. Both would be displaced by the expansion of direct state provision of publicly beneficial goods and services, financed by appropriately increased and properly targeted taxes. This should mean both more publicly beneficial goods and services, as taxation addresses the free-rider problem of private contributions, and more equitable sharing of their costs, as taxation based on ability to pay replaces the current system's implicit double tax on virtue.

Here we must sound a serious, even proverbial, reservation: the best is the enemy of the good, or will be, in the case of philanthropy, if we are not careful. Moving from the present system of Tocquevillean philanthropy to a neo-classical republican alternative poses a serious problem

¹⁵⁶ See *supra* Part II.B.2.

of the second best.¹⁵⁷ If the state decreases its support of private philanthropy before expanding its own provision of publicly beneficial services, the short-term shortfall will likely have both of two deeply undesirable outcomes.

First, net provision of private philanthropy will likely decline as its cost increases with the loss of the subsidy, particularly the donation deduction. The burden will predictably fall on those least suited to bear it, those who are poorest, who need our help most, and those who are doing what we value most highly, whose work our whole society needs most. This is likely to have an unfortunate second-order effect. As this situation becomes apparent, the most socially responsible of our citizens, those who already donate relatively more and who thus already bear the brunt of free-riding, will find themselves needing to donate still more, shouldering an even larger “tax on virtue.”

The equity of all tax reform packages depends heavily on transition rules; what we might call “transition standards” are ultimately even more important. We can identify at the macro level some of these basic “transition standards” without descending to the micro level of specific transition rules. The most significant, of course, would be to keep the fundamental challenge firmly in mind: not to

¹⁵⁷ See Richard G. Lipsey & Kelvin Lancaster, *The General Theory of the Second Best*, 24 REV. OF ECO. STUD. 11 (1956) (showing that, if one condition of Pareto optimality, the “first best,” is absent, then achieving the second best requires departing from other first-best conditions).

remove the state's support of private philanthropy until the state is in a position to meet the additional burdens necessarily placed upon it. More specifically, the state would have to co-ordinate the decrease in the tax subsidy of Tocquevillean philanthropy with an increase in the tax revenues necessary to finance direct state provision of public benefits.

That, alas, is the point that sweeping reform will not likely get past. At least for the foreseeable future, calling for increased taxes, even carefully targeted at those most able to pay and calculated to produce net gains in social wealth, will continue to be political anathema. In the face of that blunt reality, the second best solution, sad to say, is that the present system of subsidizing Tocquevillean philanthropy will have to stay pretty much as it is until the climate for progressive tax increases improves.

But that is not to say that nothing is to be done in the interim. In the neo-classical republican ideal, a primary function of both private philanthropy and the state is to educate citizens about public affairs. Promoting public debate about the dubious subsidy of Tocquevillean democracy is thus at least a step in the neo-classical republican direction. It will be a long haul, but all hauls begin the same way: shouldering the burden, striding forward with clear directions about the right path.

V. CONCLUSION: PHILANTHROPY FOR A TOCQUEVILLEAN DEMOCRACY OR A NEO-CLASSICAL REPUBLIC?

The Internal Revenue Code's charitable exemption and deduction clearly treat philanthropy favorably. The question for tax theory has always been why, and how well. The traditional subsidy theory offered no means of comparing the relative goodness of one philanthropic purpose with another, or of comparing philanthropic providers of a good or service with alternative supplies in the for-profit or governmental sectors. It simply accepted that all philanthropy, whatever that was, was good and deserving of favorable tax treatment. It made no effort either to identify the common goodness or distinguish the distinctive goodness of particular philanthropic purposes. Faced with the question of why such ill-defined goodness merited favorable tax treatment over for-profit suppliers of the same goods, traditional subsidy theory pointed vaguely to several meta-benefits: pluralism and diversity, innovation and productive efficiency.

Later theorists took this to be intellectually embarrassing, if not politically dangerous. It seemed to pose a dilemma: On pain of losing both the exemption and the deduction, either prove that they are not tax expenditures or show what "goodness" about philanthropy warrants this form of indirect government subsidy. Two sets of answers emerged, each seizing one of the horns of the dilemma. Technical definition theorists took on the tax expenditure question and metabenefit theorists took on the merits of philanthropy's case for subsidy.

For all their differences, the critiques of the traditional subsidy theory shared one common feature:

scrupulous refusal to say how some goods and services are normatively better than others. This seems, on its face, to be a serious deficiency, if not an outright vice. However, on closer inspection, we have seen it to be an odd virtue, borne of the need to fit our understanding of charity to our capitalist market economy on the one hand and our liberal democratic polity on the other. If our philanthropy is to be both populist and consumerist, it must be agnostic about both human need and human excellence and it must leave the specification of philanthropy's dual traditional aims to the market and the electorate. That, we have seen, is the implicit genius of the traditional subsidy theory. On closer inspection, it does not fail to specify the goodness of particular philanthropic purposes; it simply leaves that decision to the philanthropic themselves, bowing deeply to Tocquevillean democracy.

But we have also seen that that obeisance is one our republic need not make; indeed, in honoring both philanthropy's better traditions and its own, it is one that our republic should not make. We need not conform our philanthropy to the two-sided mold of our current economics and politics, if we prefer other politics and other ethics. Borrowing from deep traditions in our philanthropic sector, we can, instead, see this mold as an Iron Maiden, profoundly damaging to what we believe best in both our society and ourselves. The function of philanthropy, from that perspective, is not to conform to this world, but to transform this world into its own image. At the very least, that would give both market capitalism and liberal

democracy a human face and a humane spirit. At the very best, it would move our whole society past self-congratulating and self-aggrandizement toward the public virtues of the American founders and the classical philosophers. Toward that goal, removing the federal tax code's underwriting of Tocquevillean democracy would not be the worst place to start—nor, alas, the easiest.